

# EXHIBIT 1

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933

Release No. 8751 / November 14, 2006

SECURITIES EXCHANGE ACT OF 1934

Release No. 54745 / November 14, 2006

ADMINISTRATIVE PROCEEDING

File No. 3-12478

In the Matter of

City of San Diego, California,

Respondent.

ORDER INSTITUTING CEASE-  
AND-DESIST PROCEEDINGS,  
MAKING FINDINGS, AND  
IMPOSING A CEASE-AND-DESIST  
ORDER PURSUANT TO SECTION  
8A OF THE SECURITIES ACT OF  
1933 AND SECTION 21C OF THE  
SECURITIES EXCHANGE ACT OF  
1934

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against the City of San Diego, California (the "City" or "Respondent").

II.

In anticipation of the institution of these proceedings, the City has submitted an Offer of Settlement ("Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, the City consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

### III.

On the basis of this Order and the City's Offer, the Commission finds that:<sup>1</sup>

#### A. SUMMARY

This matter involves the City of San Diego's violations of the antifraud provisions of the federal securities laws in connection with the offer and sale of over \$260 million in municipal bonds in 2002 and 2003. At the time of these offerings, City officials knew that the City faced severe difficulty funding its future pension and health care obligations unless new revenues were obtained, pension and health care benefits were reduced, or City services were cut. The City's looming financial crisis resulted from (1) the City's intentional under-funding of its pension plan since fiscal year 1997; (2) the City's granting of additional retroactive pension benefits since fiscal year 1980; (3) the City's use of the pension fund's assets to pay for the additional pension and retiree health care benefits since fiscal year 1980; and (4) the pension plan's less than anticipated earnings on its investments in fiscal years 2001 through 2003.

Despite the magnitude of the problems the City faced in funding its future pension and retiree health care obligations, the City conducted five separate municipal bond offerings, raising more than \$260 million, without disclosing these problems to the investing public. In each of these offerings, the City prepared disclosure documents that are used with municipal securities offerings—that is, preliminary official statements and official statements—and made presentations to rating agencies.<sup>2</sup> In addition, in 2003 it prepared and filed information pursuant to continuing disclosure agreements under Exchange Act Rule 15c2-12 with respect to \$2.29 billion in outstanding City bonds and notes.<sup>3</sup> Although the City provided some disclosure about its pension and retiree health care obligations, it did not reveal the gravity of the City's financial problems, including that:

- The City's unfunded liability to its pension plan was expected to dramatically increase, growing from \$284 million at the beginning of fiscal year 2002 and \$720

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<sup>1</sup> The findings herein are made pursuant to the City's offer of settlement and are not binding on any other person or entity in this or any other proceeding.

<sup>2</sup> An official statement is a document prepared by an issuer of municipal bonds that discloses material information regarding the issuer and the particular offering. A preliminary official statement is a preliminary version of the official statement that is used to describe the proposed new issue of municipal securities prior to the determination of the interest rate(s) and offering price(s). The preliminary official statement may be used to gauge interest in an issue and is often relied upon by potential purchasers in making their investment decisions.

<sup>3</sup> Continuing disclosures are disclosures of material information relating to prior years' municipal bond offerings that are periodically provided to the marketplace by the bonds' issuer pursuant to contractual agreements and Exchange Act Rule 15c2-12.

million at the beginning of fiscal year 2003 to an estimated \$2 billion at the beginning of fiscal year 2009;

- The City's total under-funding of the pension plan was also expected to increase dramatically, growing tenfold from \$39.2 million in fiscal year 2002 to an estimated \$320 to \$446 million in fiscal year 2009;
- The City's projected annual pension contribution would continue to grow, from \$51 million in 2002 to \$248 million in 2009; and
- The estimated present value of the City's liability for retiree health benefits was \$1.1 billion.

The City's enormous pension and retiree health liabilities and failure to disclose those liabilities placed the City in serious financial straits. When the City eventually disclosed its pension and retiree health care issues in fiscal year 2004, the credit rating agencies lowered the City's credit rating. The City also has not obtained audited financial statements for fiscal years 2003, 2004, and 2005.

Consequently, the City violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit the making of any untrue statement of material fact or omitting to state a material fact in the offer or sale of securities.<sup>4</sup>

## **B. THE RESPONDENT**

**City of San Diego, California** is a California municipal corporation with all municipal powers, functions, rights, privileges, and immunities authorized by the California Constitution and laws, including the power to issue debt. The City is the seventh most populous city in the country, with approximately 1.3 million residents.

## **C. RELATED PARTY**

**San Diego City Employees' Retirement System ("CERS")** is a defined benefit plan<sup>5</sup> established by the City to provide retirement, disability, death, and retiree benefits to its members,

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<sup>4</sup> The Commission acknowledges that in the City's offering documents for sewer revenue bonds issued in 1995, 1997, and 1999 and sewer revenue bonds that were offered but not issued in 2003, in its continuing disclosures, and in its communications with rating agencies, the City failed to disclose that the City's wastewater fee rate structure did not comply with certain federal and state clean water laws, that the City was not in compliance with the terms of certain government grants and loans, and that the City could have been required to repay those grants and loans due to such non-compliance. The offerings in the 1990s, however, predate the offerings that are the subject of this Order, and the City did not consummate the 2003 offering because issues arose regarding the adequacy of its pension disclosure. In addition, in 2004, the City came into compliance with the federal and state clean water laws and the grant and loan covenants by adopting a new fee rate structure. The City thereby avoided having immediately to repay the government grants and loans.

<sup>5</sup> A defined benefit plan is a traditional pension plan under which pre-determined retirement benefits are based on a formula established by factors such as age, years of service, and



i.e., City employees and their beneficiaries. CERS is administered by the CERS Board, which during the relevant period included eight City employees, including the City Treasurer and the Assistant City Auditor and Comptroller, one retiree, and three non-employee City citizens appointed by the City Council as CERS Board members.

#### **D. FACTS**

##### **1. Background**

###### **a. Structure of the City's Government**

Until January 2006, the City's form of government was a city manager system.<sup>6</sup> Legislative powers of the City were vested in the City Council ("Council"), which made policies and appointed a professional city manager to carry out those policies. The Council was composed of nine full-time Council members who served for staggered four-year terms. Eight of the Council members represented the City's eight districts. The Mayor, who was elected at large, presided at the meetings of the Council and served as the official head of the City for ceremonial purposes. The Mayor and each Council member had one vote; the Mayor had no veto power.

Prior to 2006, the City Manager ("Manager") was the City's chief administrative officer and had substantial control over local government decisions. The Manager, appointed by the Mayor and Council, advised the Council of the City's present and projected financial condition, appointed and removed all city department heads (except the City Auditor and Comptroller ("City Auditor"), City Attorney, and City Clerk), prepared the City's budget, and carried out the Council's budget plan. During the relevant time period, the City's general fund budget was less than \$900 million. The City Manager had several Deputy City Managers, one of whom was in charge of the Financing Services Department, which had responsibility for overseeing the City's issuance of municipal securities.

Prior to 2006, the City Auditor was also appointed by the Council, and was required to file at least monthly with the City Manager and Council a summary statement of revenues and expenses for the preceding accounting period.<sup>7</sup> The Auditor was the City's chief financial officer and was responsible for the preparation and issuance of the City's Comprehensive Annual Financial Reports, also referred to as CAFRs. The City's Comprehensive Annual Financial Reports included audited financial statements prepared pursuant to standards established by the

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compensation, and in which the employer bears risk if the employer and employee contributions and the investment return on those contributions are not sufficient to fund the pension benefits.

<sup>6</sup> In January 2006, the City transitioned from a City Manager / Council form of government to a strong Mayor form of government. Under the new system, the Mayor became the City's chief executive officer and the City Manager's position was eliminated. The Council continues to act as the legislative body. City of San Diego City Charter, Article XV.

<sup>7</sup> City of San Diego City Charter, Article V, Section 39.

Government Accounting Standards Board ("GASB")<sup>8</sup> and various statistical, financial, and other information about the City. Portions of the Comprehensive Annual Financial Reports for the years ended June 30, 2001, and June 30, 2002 were attached as appendix B to the preliminary official statements and the official statements. The Comprehensive Annual Financial Reports for 2001 and 2002 were also filed as continuing disclosures.

The elected City Attorney served as the chief legal officer for the City. The City Attorney's office advised the Council, City Manager, and all City departments on legal matters, including disclosure in the City's securities offerings. The City Attorney was responsible for preparing all ordinances, resolutions, contracts, and other legal documents.

#### **b. The City's Pension Plan**

The City provided a defined benefit pension plan and retiree health care benefits to its employees through CERS. CERS functioned as a trust for the benefit of its members (i.e., approximately 18,500 current and former City employees and officials). The City was the creator of the trust and determined its terms, including the members' required contributions and the levels of benefits. CERS was administered by a Board of Administration, which controlled the investment of CERS's funds and which owed fiduciary duties to CERS members. CERS's assets consisted of past contributions by the City and CERS members and investment earnings on those funds. CERS's liabilities consisted of operating expenses and the future pension benefits that were owed to members.

Each year, CERS hired an actuary to determine the value of the plan's assets and liabilities based on certain actuarial assumptions and the amount that needed to be contributed to the plan so that the plan accumulated sufficient assets to pay pension (but not health care) benefits when due.<sup>9</sup> Pursuant to the City Charter, the City was to contribute half of that amount, which was expressed in terms of a percentage of payroll expenses, with the other half to be contributed by the employees, which amount was determined as a percentage of compensation based on the employee's age upon entry into CERS.

At least three concepts were particularly important in the disclosure to the public of the City's pension obligations and funding of those obligations: (1) CERS's funded ratio; (2) the

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<sup>8</sup> GASB is the organization that establishes standards of state and local governmental accounting and financial reporting.

<sup>9</sup> An actuarial valuation is a determination by an actuary, as of a specified date, of the normal cost, actuarial accrued liability, actuarial value of the assets, and other relevant values for a pension plan based on certain actuarial assumptions. The actuarial value of assets refers to the value of cash, investments, and other property belonging to a pension plan as used by the actuary for the purpose of preparing the actuarial valuation for the pension plan. The actuarial accrued liabilities are what is owed in connection with past services, as determined by one of the actuarial cost methods. Actuarial assumptions are estimates of future events with respect to certain factors affecting pension costs, including rates of mortality, disability, employee turnover, retirement, rates of investment income, and salary increases. Actuarial assumptions are generally based on past experience, often modified for projected changes in conditions.

City's unfunded liability to CERS; and (3) the City's net pension obligation, also called the NPO. CERS's funded ratio was the ratio of its assets to liabilities. The City's unfunded liability to CERS was the dollar shortfall between CERS's assets and liabilities. The City's net pension obligation was the cumulative difference between what the City actually contributed to CERS and the amount that the City would have contributed had it conformed to a funding method recognized by GASB.

## **2. The City's Pension and Retiree Health Care Benefits and Funding of CERS**

The City failed to disclose material information regarding substantial and growing liabilities for its pension plan and retiree health care and its ability to pay those obligations in the future in the disclosure documents for its 2002 and 2003 offerings, in its continuing disclosures filed in 2003, and in its presentations to the rating agencies. As more fully described below, the City's substantial and growing pension and retiree health care liabilities resulted from several factors, including: (1) the City's intentional under-funding of its annual pension contribution; (2) the City's granting of new retroactive pension benefits; (3) the City's use of certain CERS earnings to pay for various additional pension and retiree health care benefits and to pay a portion of employees' pension contributions; and (4) CERS's earning less than anticipated returns on its investments.

### **a. The City's Historical Practice of Using "Surplus Earnings" to Fund Pension and Retiree Health Care Benefits**

In fiscal year 1980, the City began instructing CERS to use "surplus earnings"—i.e., earnings above the actuarially projected 8% return rate<sup>10</sup>—to fund an ever-increasing amount of additional benefits for CERS members. Pension plans typically retain surplus earnings to support the plan's financial soundness and to make up for years in which earnings fall short of the assumed return rate. Rather than retaining its surplus earnings, the City began using surplus earnings in fiscal year 1980 to fund an annual extra or "13<sup>th</sup> check" to retirees. The City continued using surplus earnings to pay for retiree health care benefits in fiscal year 1982 and to pay an ever-increasing amount of the employees' CERS contributions in fiscal year 1998.<sup>11</sup>

In total, the City used surplus earnings to pay pension benefits and employees' contributions totaling \$150 million as of the end of fiscal year 2001 and an additional \$25 million as of the end of fiscal year 2002. According to a 2005 CERS audit, the City's use of surplus

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<sup>10</sup> Without regard to its actual historical rate of return on investments, the CERS Board assumed an annual rate of investment return of 8%, which the actuary incorporated into his calculations. CERS defined surplus earnings as the amount of realized investment earnings in excess of the actuarially projected 8% return rate.

<sup>11</sup> In fiscal years 2003 and 2004, the City used CERS's surplus earnings from prior years to pay up to 27% of the employees' contributions.

earnings accounted for 17% of the increase in the City's unfunded liability to CERS from fiscal year 1997 through fiscal year 2003.

**b. Manager's Proposal 1: The City Proposes Additional Benefits in Exchange for Contribution Relief**

In fiscal year 1996, the City agreed to increase significantly and retroactively all employees' pension benefits. The City, however, could not afford to fund the cost of the benefit increases. The City therefore made the pension benefit increases contingent on CERS's agreement to the City's under-funding of its annual contribution to CERS.

In fiscal year 1997, the City and CERS entered into an agreement, which was referred to as Manager's Proposal 1, that set the City's annual contribution at gradually increasing rates through fiscal year 2008. This funding method, which the City termed "Corridor" funding, was not recognized by GASB and set annual funding rates that were not actuarially determined and were projected to be below GASB-recognized funding rates through fiscal year 2006. In other words, under Corridor funding, the City would be intentionally under-funding its annual liability to CERS in fiscal years 1997 through 2006.<sup>12</sup> After fiscal year 2006, it was estimated that the funding rate of Manager's Proposal 1 would equal a GASB-accepted rate. Manager's Proposal 1 also contained a provision intended to protect CERS's financial soundness. Specifically, if CERS's funded ratio fell below 82.3%, the City would have to increase its CERS contribution rate.

In fiscal years 1996 and 1997, the City estimated that under Manager's Proposal 1, by the end of fiscal year 2008, the City's net pension obligation would be \$110.35 million. Because the City's Corridor funding method was not GASB-recognized, GASB required that the City disclose its net pension obligation in its annual financial statements.

**c. The *Corbett* Litigation Requires the City to Fund Additional Retroactive Benefits**

In March 2000, the City again retroactively increased pension benefits. Specifically, the City and CERS settled a class action lawsuit brought by CERS members, with *Corbett* as the named class plaintiff.<sup>13</sup> Under the *Corbett* settlement, the City retroactively gave increased pension benefits to both current and retired City employees, increasing CERS's liabilities. Under

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<sup>12</sup> Manager's Proposal 1 was viewed skeptically by some members of the CERS Board who were not City employees. The majority of the CERS Board, however, consisted of City officials who received benefit increases that were contingent on the Board's approval of Manager's Proposal 1. Moreover, CERS's actuary informed the CERS Board that Manager's Proposal 1 was a sound proposal and CERS's fiduciary counsel opined that the Board would be acting within the ambit of its fiduciary discretion in approving Manager's Proposal 1.

<sup>13</sup> The *Corbett* plaintiffs raised various claims based on a 1997 California Supreme Court decision which held that an employee's salary for purposes of calculating basic pension benefits included the value of overtime and accrued leave.

Manager's Proposal 1, however, the City's contributions to CERS did not increase. As a result, the City's unfunded liability to CERS increased by \$185 million.

In negotiating the *Corbett* settlement, however, the City purposefully structured certain of the increased *Corbett* benefits to avoid having those benefits adversely affect CERS's reported funded ratio and the City's reported unfunded liability to CERS. Specifically, the City structured the *Corbett* settlement so that the increased benefits for retired CERS members were to be paid in a given year only if there were sufficient surplus earnings from that year to pay the benefit. If there were insufficient surplus earnings in a given year to pay the increased benefit, then the cost of the increased benefit would become CERS's liability and would eventually be paid from future years' surplus earnings. The City and CERS treated the increased benefits to retired CERS members as contingent liabilities that were not taken into account in determining CERS's funded ratio or the City's unfunded liability to CERS. As of June 30, 2001, according to CERS's actuary, if the contingent portion of the *Corbett* settlement had been included in CERS's valuation, the City's unfunded liability to CERS would have increased by \$70 to \$76 million and CERS's funded ratio would have decreased by 2% to 2 ½ % from what was actually reported by the City. Thus, the City's pension situation was even more dire than the numbers, as they were reported by the City, indicated.

**d. CERS's Actuary Report for Fiscal Year 2001 Shows a Dramatic Increase in the City's Pension Liabilities**

In fiscal year 2001, CERS's investment return began to fall short of its anticipated 8% annual return. The City was informed of CERS's declining performance in February 2002, when it received CERS's annual actuarial valuation for fiscal year 2001. This report stated that as of the end of fiscal year 2001, CERS's funded ratio was 89.9% and the City's unfunded liability to CERS was \$284 million, as compared to a funded ratio of 97.3% and an unfunded liability of \$69 million only one year earlier. Moreover, the report noted that if the *Corbett* contingent benefit to CERS retired members were included, the City's unfunded liability to CERS would have increased to at least \$354 million and CERS's funded ratio would have fallen to at least 87.9%.

CERS's actuary attributed these changes to a number of factors, including CERS's actuarial investment losses<sup>14</sup> of \$95.6 million (and warned that there would be further actuarial investment losses in fiscal year 2002 unless the markets improved during the remaining five months of the fiscal year). In his report, CERS's actuary also warned that "all parties" should be "acutely aware that the current practice of paying less than the [actuarial] computed rate of contribution ... will help foster an environment of additional declines in the funded ratio in absence of healthy investment returns."

In May 2002, the City learned that CERS would likely not have any surplus earnings from fiscal year 2002 to pay for the contingent benefits—specifically, retiree health care benefits, the 13<sup>th</sup> check, and the *Corbett* increase to retirees.

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<sup>14</sup> Actuarial investment losses are the difference between the assumed investment rate, which in the City's case was 8% annually, and the actual investment results.



**e. The Blue Ribbon Committee Report Puts the City on Notice about its Growing Pension and Retiree Health Care Liabilities**

In April 2002, the City received a warning that the City's pension and retiree health care liabilities would continue to grow and that the City was not adequately planning to meet those liabilities. This came in the form of a report from the City's Blue Ribbon Committee to the City Council.<sup>15</sup> The report stated that the Blue Ribbon Committee had three principal concerns regarding CERS. First, the City was granting retroactive retirement benefit increases but pushing the cost of those benefit increases into the future, long after the individuals involved in the decisions were gone. Second, the City's budgetary process did not adequately comprehend the steadily growing annual expense of the pension contribution, "particularly given the uncontrollable and non-discretionary nature of this liability." The Committee stated that the City's pension contribution would substantially increase and warned that any future benefit increases, particularly retroactive increases, would "significantly exacerbate this problem." Third, the City's budgetary process did not recognize that retiree health care costs were a non-discretionary expense that would grow at an increasing rate and that the City was not paying out of its current year's budget the full cost for their future retiree health benefits. This report thus squarely put the City on notice that it had substantial future pension and healthcare liabilities it would probably be unable to pay under the current system.

**f. Manager's Proposal 2: The City Again Proposes Additional Pension Benefits in Exchange for Relief from an Impending Lump Sum Payment**

In fiscal year 2003, the City again increased its pension liability by granting additional retroactive benefits, used additional CERS assets to pay for additional pension and retiree health care benefits and an increased portion of the employees' contribution, and obtained additional time to under-fund its annual CERS contribution.

In the second half of fiscal year 2002, the City agreed to increase pension benefits for fiscal year 2003. From as early as October 2001, however, the City was concerned that CERS's funded ratio would fall below the 82.3% floor established by Manager's Proposal 1, which would require the City, at the very least, to increase its contributions to CERS by at least \$25 million to be at a higher GASB-accepted rate.

Concerned about having to pay the additional \$25 million, the City sought to condition the pension benefit increases on the City's obtaining from CERS relief from the floor of Manager's Proposal 1. In November 2002, the City and CERS agreed to Manager's Proposal 2 and the City

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<sup>15</sup> In April 2001, the Mayor had appointed a nine-member committee of San Diego citizens, known as the Mayor's Blue Ribbon Committee on City Finances, to independently evaluate the City's fiscal health and make any appropriate recommendations. In February 2002, the Blue Ribbon Committee presented its report to the Council's Rules Committee, identifying nine areas of concern, two of which related to the City's pension fund. The same report was made to the full Council in April 2002.

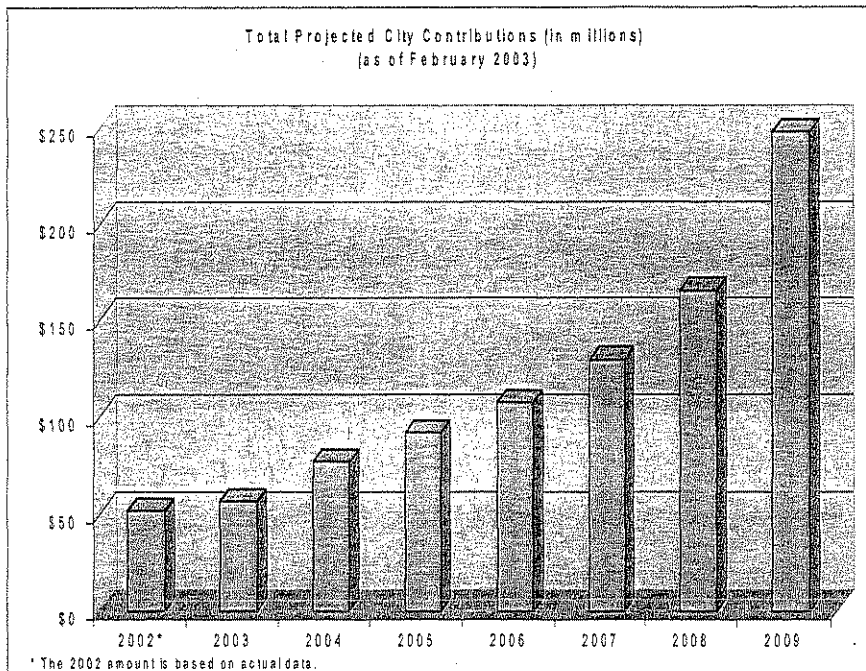
adopted the increased pension benefits as of July 2002. Under Manager's Proposal 2, once CERS's funded ratio fell below 82.3%, the City would have five years to increase its contributions to CERS to reach a GASB-recognized funding rate.

As a result of CERS's actuarial losses in fiscal year 2002, CERS did not have surplus earnings to pay the 13<sup>th</sup> check, the cost of retiree health care, and the *Corbett* benefit increase to retired CERS members. In conjunction with Manager's Proposal 2, however, the City directed CERS to use certain of its reserve accounts to pay the 13<sup>th</sup> check and the retiree health care benefits, and to pay an increased portion of certain City employees' CERS contributions. The reserve funds could have been used to increase CERS's funded ratio and decrease the City's unfunded liability to CERS; instead, the City directed that CERS use the reserve funds to pay additional benefits.

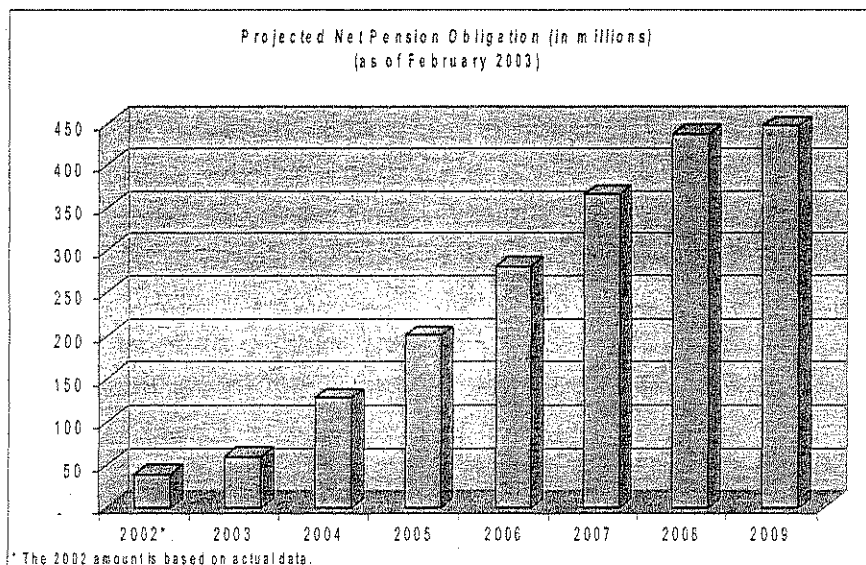
**g. CERS's Actuary Report for Fiscal Year 2002 and Projections for the Future Show that the City Faces Substantial Problems Funding its Pension and Retiree Health Care Liabilities**

In early 2003, the City received two reports from CERS's actuary. These reports provided the City with negative information regarding the present and projected status of CERS's funded ratio and the City's unfunded liability to CERS. First, in January 2003, the City received CERS's actuary report for fiscal year 2002. This report stated that during fiscal year 2002, CERS suffered an actuarial loss of \$364.8 million and that as of the end of fiscal year 2002, CERS's funded ratio was 77.3% and the City's unfunded liability to CERS was \$720 million, as compared to a funded ratio of 89.9% and unfunded liability of \$284 million only one year earlier. The actuary's report further stated that if the *Corbett* contingent benefit to CERS retired members had been included, the City's unfunded liability to CERS would have been at least \$790 million, and CERS's funded ratio would have been approximately 75.3%. In the concluding comment, the actuary stated that CERS was "in adequate condition," which was the first time that the actuary had not described CERS as "actuarially sound."

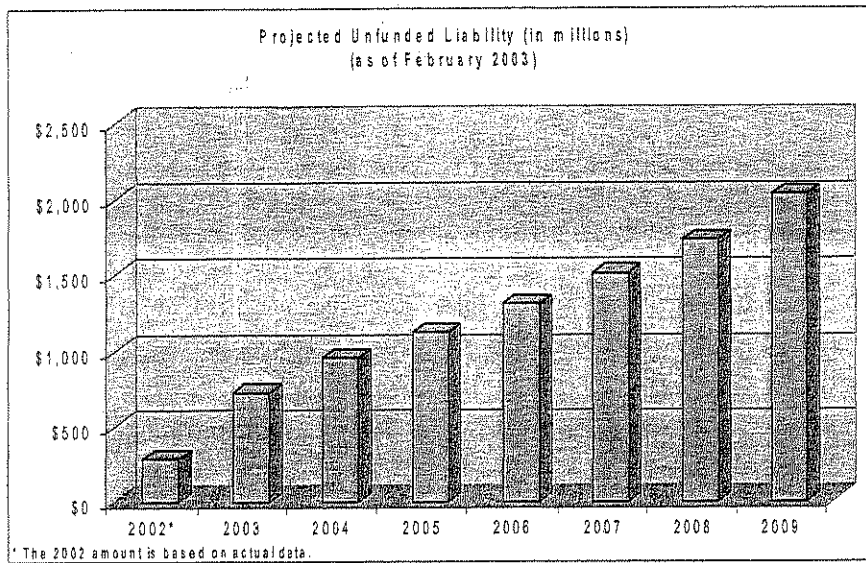
Second, in February 2003, CERS's actuary provided to the City projections of the City's contributions under Manager's Proposal 2, the City's net pension obligation, the City's unfunded liability to CERS, and CERS's unfunded ratio. Specifically, the City's contribution rate was projected to more than quadruple—from 9.83% of payroll in fiscal year 2002 (\$51 million) to 35.27% of payroll in fiscal year 2009 (\$248 million). The following chart illustrates the growth in the City's projected annual contribution to CERS:



The City's net pension obligation was projected to grow by tenfold—from \$39.23 million in fiscal year 2002 to as much as \$446 million in fiscal year 2009. The following chart illustrates the growth in the City's projected net pension obligation:



The City's unfunded liability was projected to increase more than seven fold—from \$284 million at the beginning of fiscal year 2002 to \$2 billion at the beginning of fiscal year 2009. CERS's funded ratio was projected to continue to fall—from 77.3% at the beginning of fiscal year 2003 to 65.6% at the beginning of fiscal year 2009. The following chart illustrates this dramatic increase in the City's projected unfunded liability to CERS:



The City had knowledge of these projections prior to all of its 2003 municipal securities offerings.

**h. The *Gleason* Litigation: CERS Members Challenge Manager's Proposal 1 and Manager's Proposal 2**

Further evidence that the City's under-funding of CERS was potentially threatening the City's future fiscal health came in January 2003, when CERS members filed a class action, with *Gleason* as the named class plaintiff, against the City and CERS alleging breaches in connection with the City's under-funding of CERS under Manager's Proposal 1 and Manager's Proposal 2. Among other things, the *Gleason* complaint alleged that by 2009, the City would owe approximately \$2.8 billion to CERS, with an annual City budget expense of more than \$250 million. In March 2003, the CERS attorney in the *Gleason* litigation advised CERS that (1) certain CERS Board members had breached their fiduciary duty by adopting Manager's Proposal 2; and (2) CERS should exercise its right to nullify Manager's Proposal 2. The CERS Board, which included the City Treasurer and the Assistant City Auditor and Comptroller, rejected this advice. If Manager's Proposal 2 had been nullified, the City would have been required to make an immediate potential payment to CERS of up to \$159 million.

**i. CERS's Response to the Blue Ribbon Committee Report Advises the City's Officials of the Growing Pension and Retiree Health Care Crisis.**

In February 2003, additional detailed information about the City's pension funding crisis was presented to City officials when CERS responded to the Blue Ribbon Committee's report.<sup>16</sup> In its response, CERS advised the City that as of June 30, 2002, CERS's funded ratio had fallen to 77.3% and the City's unfunded liability to CERS had increased to \$720 million. The response also stated that the falling funded ratio and the increasing unfunded liability resulted from three factors: a dramatic decline in CERS's investment performance in fiscal years 2001 and 2002; the City's granting of increased benefits; and the City's contributions to CERS at less than a GASB-recognized rate.

With respect to the City's under-funding, the response stated that the annual amount of the City's under-funding of CERS continued to increase in fiscal years 2002 and 2003, which was contrary to the initial projections from Manager's Proposal 1 that the annual amount of under-funding would decline beginning in fiscal year 2001. The response further stated that the City's net pension obligation would reach \$102 million by the end of fiscal year 2003 and \$423 million by the end of fiscal year 2009.

The response also discussed the City's future liability for retiree health care. CERS's actuary had estimated that the present value of the City's liability for future retiree health care was in excess of \$1.1 billion. The response further stated that the City was not making any contributions to CERS to pay for this liability, that CERS had been paying for this liability with money in a reserve funded with CERS's surplus earnings from prior years, that the reserve would be depleted in fiscal year 2006, and that in fiscal year 2006, the City would have to pay an estimated \$15 million for retiree health care. The response warned that absent a change in the benefit and a dramatic decrease in future health care costs, the City could be facing significant future funding obligations. The response recommended that the City consider funding this future health care liability as part of its annual contribution to CERS.

**j. The City's Study of Its Pension Obligations Concludes that the City's Pension Liabilities Could Negatively Impact the City's Credit Rating**

In April 2003, the City received additional information regarding the projected growth of its future pension liabilities and the possible negative effect those liabilities would have on the City's credit rating and ability to issue municipal securities. In February 2003, the City hired a financial adviser to analyze CERS's funding and to develop potential solutions. On April 16,

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<sup>16</sup> From February 9 through 13, 2003, the local newspaper wrote three front page, above-the-fold articles about the City's under-funded pension system and the CERS response. The newspaper articles explained that (1) by the end of FY 2009 the City's unfunded liability to CERS was projected to increase to almost \$2 billion; and (2) the City's unfunded liability for retiree health care was estimated to be \$1.1 billion.



2003, the financial adviser provided to the City a preliminary pension analysis. In its analysis, the financial adviser stated that because of the City's under-funding, the City's unfunded liability would continue to grow and CERS's funded ratio would continue to fall through fiscal year 2021 regardless of actuarial gains or losses. The financial adviser estimated that under Manager's Proposal 2, the City's unfunded liability to CERS would grow to \$1.9 billion at the end of fiscal year 2009 and to \$2.9 billion at the end of fiscal year 2021, and CERS's funded ratio would fall to 66.5% at the end of fiscal year 2009 and would be 67% at the end of fiscal year 2021.

The preliminary pension analysis also stated that the City's large unfunded liability to CERS would cause the City's contribution to CERS to increase dramatically. The analysis estimated that the City's contribution rate to CERS would more than double—from 18.87% of payroll (or \$107.5 million) in fiscal year 2004 to 40.9% of payroll (\$286.9 million) in fiscal year 2009.

The preliminary pension analysis also discussed the effect that the City's unfunded liability would have on the City's credit rating. The financial adviser stated that the City's current unfunded liability would not only trigger an adverse credit event but that the rating agencies would expect the City to develop a plan to reduce its unfunded liability by increasing its annual contributions and/or funding the unfunded liability by issuing bonds. The financial adviser further stated that if the City did not develop and implement such a plan, the City's unfunded liability could cause the City "significant credit and legal challenges." The City's disclosures in 2003 failed to inform investors of the financial adviser's analysis.

### **3. The Offerings, Continuing Disclosures, and Rating Agency Presentations**

#### **a. The Bond Offerings and the City's Preparation of the Offerings' Disclosure Documents**

During 2002 and 2003, the City conducted the following five municipal securities offerings totaling \$261,850,000 in par value:

- \$25,070,000 Public Facilities Financing Authority of the City of San Diego Lease Revenue Bonds, Series 2002B (Fire and Safety Project ) (June 2002)
- \$93,200,000 City of San Diego, 2002-03 Tax Anticipation Notes Series A (July 2002)
- \$15,255,000 City of San Diego/Metropolitan Transit Development Board Authority 2003 Lease Revenue Refunding Bonds (San Diego Old Town Light Rail Transit Extension Refunding (April 2003)
- \$17,425,000 City of San Diego 2003 Certificates of Participation (1993 Balboa Park/Mission Bay Park Refunding) (May 2003)
- \$110,900,000 City of San Diego 2003-04 Tax Anticipation Notes Series A (July 2003)

A transactional financing team prepared the offering documents, that is, the preliminary official statement and the official statement, for each of the five municipal bond offerings. The

financing team consisted of outside consultants and officials from the City Manager's office (financing services division), Auditor and Comptroller's office, and the City Attorney's office. The outside consultants included, among others, bond counsel, disclosure counsel, and underwriters. The preliminary official statement and the official statement for each of the five offerings consisted of a description of the offering, a general description of the City, including financial, economic, statistical, and other information in appendix A, and audited annual financial statements from the City's Comprehensive Annual Financial Reports in appendix B. Information regarding its pension and retiree health care obligations was provided in both appendices A and B.

The outside consultants took the lead in drafting the description of the bond offerings. City officials in the financing services division were responsible for drafting appendix A. The financing services division updated Appendix A on an ongoing basis and at the time of a bond offering, forwarded the latest version of Appendix A to the entire financing team. The team met several times to review, comment on, and ultimately finalize the preliminary official statements and official statements at "page-turner meetings." Appendix B was prepared by the Auditor's office and the City's outside auditor. The Council approved all of the 2002 and 2003 offerings at open session meetings.

#### **b. The Continuing Disclosures**

During the relevant period, the City also filed annual continuing disclosures relating to its \$2.29 billion in outstanding bonds for the purpose of updating investors on the state of the City's finances.<sup>17</sup> City officials in the financing services division coordinated, reviewed, and filed the 2002 and 2003 continuing disclosures. Almost all of these continuing disclosures included appendix A and portions of the City's Comprehensive Annual Financial Reports. The financing services division was responsible for ensuring that the most updated and accurate version of appendix A was attached to the continuing disclosures before they were filed.

#### **c. The 2003 Rating Agency Presentations**

The City made presentations to the rating agencies on a yearly basis, both in connection with specific bond offerings and to update the rating agencies on the City's general credit. The presentations were made orally with PowerPoints in meetings with representatives from Fitch Ratings, Moody's Investors Service, and Standard and Poor's. In 2003, the rating agencies specifically asked the City to address the pension plan as part of its annual presentations. These presentations were important because they directly affected the City's bond ratings. The 2003

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<sup>17</sup> An underwriter of municipal securities covered by Exchange Act Rule 15c2-12 may not purchase or sell municipal securities in connection with an offering unless the issuer has undertaken in a written agreement or contract for the benefit of the bondholders to provide its audited annual financial statements and certain other annual financial and operating information, to nationally recognized municipal securities information repositories and state information depositories designated by the Commission and to provide notices of certain material events and notices of any failures to file on the nationally recognized municipal securities information repositories or the Municipal Securities Rulemaking Board and state information depositories.

PowerPoint presentations were prepared and presented by officials from the City Manager's office, including the financing services division, and the City Auditor and Comptroller's office. The financing services division drafted the pension portion of the 2003 PowerPoint presentation. Officials from the City Auditor's office made the oral presentation on the pension plan and fielded numerous questions on that topic from the rating agencies.

#### **4. The False and Misleading Disclosures**

In the preliminary official statement and the official statements for the 2002 and 2003 offerings, the 2003 presentations to the rating agencies, and the 2003 continuing disclosures, the City made substantial disclosures regarding (1) the City's policies for funding CERS; and (2) the status of CERS's funding and the City's liability to CERS. Additionally, in the preliminary official statements, the official statements, and continuing disclosures, the City made certain representations regarding its retiree health care obligations. The disclosures (collectively "Disclosures"), however, were misleading because the City failed to include material information regarding the City's current funding of its pension and retiree health care obligations, the City's future pension and retiree health care obligations, and the City's ability to pay those future obligations.

First, with respect to the pension issues, the City failed in the Disclosures to reveal several material facts, including that (1) the City was intentionally under-funding its pension obligations so that it could increase pension benefits but push off the costs associated with those increases into the future; (2) because of the City's under-funding of its pension plan, its net pension obligation was expected to continue to grow at an increasing rate, reaching from \$320 million to \$446 million by the end of fiscal year 2009; (3) the City's unfunded liability was expected to continue to grow at a substantial rate, reaching approximately \$2 billion by fiscal year 2009; (4) this growth in the City's unfunded liability resulted from the City's intentional under-funding of its pension plan, the City's granting of new retroactive pension benefits, the City's use of pension plan earnings to pay additional benefits, and the pension plan's less than anticipated investment return; (5) the City's annual pension contribution was expected to more than quadruple by fiscal year 2009; and (6) the City would have difficulty funding its future annual pension contributions unless it obtained new revenues, reduced pension benefits, or reduced City services. Moreover, the City falsely disclosed in Appendix B to its preliminary official statements and its official statements that its net pension obligation was funded in a reserve.

Additionally, with respect to retiree health care benefits, the City failed to disclose in its preliminary official statements, official statements, and continuing disclosures that<sup>18</sup> (1) the estimated present value of its liability for retiree health care was \$1.1 billion; (2) the City had been covering the annual cost for retiree health care with pension plan earnings from prior years that were expected to be depleted in fiscal year 2006; (3) after fiscal year 2006, the City would have to pay for the retiree health care benefits from its own budget at an estimated annual cost of \$15 million; and (4) the City had not planned for paying such additional costs.

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<sup>18</sup> The issue of retiree health care was not addressed in the rating agency presentations.

## **5. The City's Knowledge of the Misleading Disclosures**

The City, through certain of its officials, knew that its Disclosures were misleading. The Mayor and Council were responsible for approving the issuance of the bonds and notes, including issuance of the preliminary official statements and official statements. The Mayor and Council delegated final approval of the official statements to the City Manager. The City Manager's office was responsible for the preparation of the preliminary official statements and the official statements, including appendix A. The City Auditor's office was responsible for the preparation of appendix B to the preliminary official statements and official statements. Through their designees on the CERS Board, among other things, both the City Manager's and the City Auditor's offices had knowledge about the City's use of CERS's surplus earnings, Manager's Proposals 1 and 2, CERS's actuary reports for fiscal years 2001 and 2002, and CERS's response to the Blue Ribbon Committee Report. Also, several representatives of the City Manager's office, City Attorney's office, and Auditor and Comptroller's office attended relevant closed session meetings of the Council where Manager's Proposals 1 and 2 and the *Corbett* and *Gleason* litigations were discussed. Moreover, the Blue Ribbon Committee Report and CERS's response to the Blue Ribbon Committee Report were both presented to a committee of the Council at which officials from the City Manager's and Auditor and Comptroller's office were present. Finally, the offices of the City Manager and the City Auditor were responsible for the City's study of its pension obligations that occurred in early 2003. Through their participation and involvement in the above-referenced matters, certain city officials knew or were reckless in not knowing that the Disclosures were false and misleading.

Specifically, by early 2002, the City, through its officials, knew, among other things, that (1) CERS's funded ratio would likely fall below the 82.3% floor set by Manager's Proposal 1; (2) the City was proposing Manager's Proposal 2 to avoid the effects of CERS's falling below the floor; (3) Manager's Proposal 2 allowed the City more time to under-fund CERS; and (4) the Blue Ribbon Committee had raised concerns about the City's under-funding of CERS and the future retiree health care liability. By early 2003, the City, through its officials, knew, among other things, that (1) the City's projected total contributions to CERS would grow from \$77 million in fiscal year 2004 to \$248 million in fiscal year 2009; (2) CERS had fallen below the 82.3% floor of Manager's Proposal 1; (3) the City and CERS had adopted Manager's Proposal 2 to allow the City more time to under-fund CERS; and (4) CERS was using reserved surplus earnings to pay certain benefits and to pay an increased portion of the employees' CERS contribution.

## **6. Materiality and the City's Voluntary Disclosure**

The misleading Disclosures were material in view of the City's overall financial health. The Disclosures were also material given the magnitude of the City's projected annual CERS payments in the future and the potential consequences of those liabilities to the City, including inability to make the payments without reduction in other services.

The nature and level of under-funding brought into question the City's ability to fund the pension and health care benefits in the future as well as its ability to repay the bonds and notes. Under such a scenario, the City could be forced to choose between paying pension contributions, paying what the City owes on its bonds and notes, reducing services, and/or raising fees and taxes.

The materiality of the misleading Disclosures was demonstrated by the impact on the City's bond ratings when it finally disclosed key facts about the pension plan on January 27, 2004 in a voluntary report of information, after a non-employee CERS Board member raised concerns about the City's disclosure. The voluntary report provided information regarding (1) CERS's current and estimated future funded status; (2) the City's current and estimated future liabilities to CERS; (3) the reasons for the substantial decrease in CERS's funded ratio and increase in the City's liability to CERS; (4) the City's previous use of CERS funds to pay for retiree health care and the City's estimated future liabilities for retiree health care; and (5) the City's anticipated difficulty funding its increasing CERS contribution without new City revenues, a reduction in pension benefits, a reduction in City services, or other actions. Shortly after the disclosures in the voluntary report, the rating agencies lowered their ratings on the City's bonds and notes.

**E. Legal Discussion**

**1. The Securities Act and Exchange Act Antifraud Provisions**

State and local governments are exempt from the registration and reporting provisions of the Securities Act and the Exchange Act. Similarly, the Commission's authority to establish rules for accounting and financial reporting under Section 19 of the Securities Act and Section 13(b) of the Exchange Act does not extend to municipal securities issuers. The City and other municipal securities issuers, however, are subject to the antifraud provisions of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. In addition, the Commission has promulgated a broker-dealer rule, Exchange Act Rule 15c2-12, which in general limits market access for certain municipal securities issues to those offerings in which the issuer agrees to file annual financial disclosures of specified financial and operating information as well as notices of certain events, if material, and notices of any failures to file with repositories designated by the Commission. The antifraud rules apply to such disclosure and to any other statements made to the market.

Section 17(a) of the Securities Act prohibits misrepresentations or omissions of material facts in the offer or sale of securities. Section 10(b) of the Exchange Act and Rule 10b-5 thereunder prohibit misrepresentations or omissions of material fact in connection with the purchase or sale of any security. These provisions prohibit the making of any untrue statement of material fact or omitting to state a material fact in the offer, purchase, or sale of securities. A fact is material if there is a substantial likelihood that its disclosure would be considered significant by a reasonable investor. Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1987); TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 require a showing that defendants acted with scienter. Aaron v. SEC, 446 U.S. 680, 701-02 (1980). Scienter is "a mental state embracing intent to deceive, manipulate or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976). In the Ninth Circuit, recklessness satisfies the scienter requirement. Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1569 (9th Cir. 1990) (en banc). Recklessness is "an extreme departure from the standards of ordinary care, and which presents a danger of misleading [investors] that is either known to the defendant or is so obvious



that the actor must have been aware of it.” *Id.*, 914 F.2d at 1569. Scienter, however, need not be shown to establish a violation of Section 17(a)(2) or (3). *Aaron v. SEC*, 446 U.S. 680, 697 (1980). Violations of these sections may be established by showing negligence. *SEC v. Hughes Capital Corp.*, 124 F.3d 449, 453-54 (3d Cir. 1997); *SEC v. Steadman*, 967 F.2d 636, 643 n. 5 (D.C. Cir. 1992).

## **2. The City’s Violations of the Antifraud Provisions of the Securities Act and the Exchange Act**

The City’s public disclosures in the preliminary official statements and official statements for its 2002 and 2003 offerings, its 2003 continuing disclosures, and presentations to the rating agencies failed to disclose material information regarding the City’s current funding of its pension and retiree health care obligations, the City’s future pension and retiree health care obligations, and the City’s ability to pay those future obligations. The omission of this information caused the information that was disclosed to be misleading.

This information was material to investors. The magnitude of the City’s unfunded liabilities was enormous. For example, the City knew that by 2009 the unfunded liability would reach \$1.9 billion and its actuarially required contribution would be approximately \$240 million compared to \$51 million in FY 2002. The City’s under-funding of CERS and unfunded liabilities to CERS and for retiree health care were projected to continue to grow at an increasing rate. The increase in the City’s under-funding and unfunded liabilities resulted, in part, from the City’s decisions to increase pension and retiree health care benefits but push the costs of those increases into the future, to use CERS’s prior earnings to cover additional benefits, and to pay a portion of the employees’ contribution to CERS. All of this information raised a question whether the City could pay for these pension and retiree health care obligations and repay the bonds and notes issued by and on behalf of the City.

The City, through its officials, acted with scienter.<sup>19</sup> City officials who participated in drafting the misleading disclosure were well aware of the City’s pension and retiree health care issues and the magnitude of the City’s future liabilities. Moreover, even though the City officials knew that the City’s pension issues were of concern to the rating agencies, they failed to disclose material information regarding the City’s pension and retiree health care issues. In light of the City’s officials’ detailed knowledge of the magnitude of the City’s pension and retiree health care liabilities and of the rating agencies’ interest in those liabilities, the City officials acted recklessly in failing to disclose material information regarding those liabilities.

## **F. REMEDIAL EFFORTS AND UNDERTAKINGS**

1. Since 2005, Respondent has implemented several remedial measures with a view to detect and prevent securities violations. Specifically, the City has terminated certain officials in the City Manager’s and Auditor and Comptroller’s offices or has allowed them to resign. The City has filled these positions with new employees generally having significant relevant experience with

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<sup>19</sup> The City’s scienter is based on the mental state of its officials. *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1089 n.3 (2d Cir. 1972).

other municipal governments or the private sector. The City has hired a full time municipal securities attorney who is responsible for coordinating the City's public disclosure and who has conducted continuing education for the City's deputy attorneys on the City's disclosure requirements.

2. The Mayor resigned and has been replaced by a former City police chief. In January 2006, pursuant to a public referendum, the City changed from a strong city manager form of government to a strong mayor form of government.

3. The City has hired new outside professionals including new auditors for its fiscal year audits. The City also hired individuals not affiliated with the City to act as the City's Audit Committee and charged the Committee with investigating the City's prior disclosure deficiencies and making recommendations to prevent future disclosure failures. The City has also hired new disclosure counsel for all of its future offerings, who will have better and more continuous knowledge on the City's financial affairs. This disclosure counsel has conducted seminars for City employees on their responsibilities under the federal securities laws.

4. The City has also enacted ordinances designed to change the City's disclosure environment. First, the City created a Disclosure Practices Working Group, comprised of senior City officials from across city government. The Working Group is charged with reviewing the form and content of all the City's documents and materials prepared, issued, or distributed in connection with the City's disclosure obligations relating to securities issued by the City or its related entities; and conducting a full review of the City's disclosure practices and to recommend future controls and procedures. Second, the Mayor and City Attorney must now personally certify to the City Council the accuracy of the City's official statements. Third, the City Auditor must annually evaluate the City's internal financial controls and report the results to the City Council.

5. Respondent shall comply with the following undertakings to:

- a. Retain, not later than 60 days after the date of this Order, at its expense, an independent consultant not unacceptable to the Commission's staff (the "Independent Consultant"). The City shall require the Independent Consultant to (a) conduct annual reviews for a three-year period of the City's policies, procedures, and internal controls regarding its disclosures for offerings, including disclosures made in its financial statements, pursuant to continuing disclosure agreements, and to rating agencies, the hiring of internal personnel and external experts for disclosure functions, and the implementation of active and ongoing training programs to educate appropriate City employees, including officials from the City Auditor and Comptroller's office, the City Attorney's office, the Mayor, and the City Council members regarding compliance with disclosure obligations; (b) make recommendations concerning these policies, procedures, and internal controls with a view to assuring compliance with the City's disclosure obligations under the federal securities laws; and (c) assess, in years two and three, whether the City is complying with its policies, procedures, and internal controls, whether the City has adopted any of the Independent Consultant's recommendations from prior year(s) concerning such policies, procedures, and internal controls for disclosures

for offerings, and whether the new policies, procedures, and internal controls were effective in achieving their stated purposes;

- b. No later than 10 days following the date of the Independent Consultant's engagement, provide to the Commission staff a copy of an engagement letter detailing the Independent Consultant's responsibilities pursuant to paragraph 5(a) above;
- c. Arrange for the Independent Consultant to issue its first report within 120 days after the date of the engagement and the following two reports within 60 days following each subsequent one-year period from the date of engagement. Within 10 days after the issuance of the reports, the City shall require the Independent Consultant to submit to Kelly Bowers of the Commission's Pacific Regional Office a copy of the Independent Consultant's reports. The Independent Consultant's reports shall describe the review performed and the conclusions reached and shall include any recommendations deemed necessary to make the policies, procedures, and internal controls adequate and address the deficiencies set forth in Section III.D of the Order. The City may suggest an alternative method designed to achieve the same objective or purpose as that of the recommendation of the Independent Consultant provided that the City's Mayor and City Attorney certify in writing to the Commission staff that they have a reasonable belief that the alternative method is expected to have the same objective or purpose as that of the Independent Consultant's recommendation;
- d. Take all necessary and appropriate steps to adopt, implement, and employ the Independent Consultant's recommendations or the City's alternative method designed to achieve the same objective or purpose as that of the Independent Consultant's recommendation; and
- e. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with the City, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity; provided however, that the Independent Consultant may enter into an agreement with the City to serve as an independent monitor to oversee the City's remedial efforts with respect to enhanced accountability, greater transparency, increased fiscal responsibility, and independent oversight. Except as permitted above, the agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Pacific Regional Office, enter into any employment, consultant, attorney-client, auditing or other professional relationship with the City, or any of its present or former affiliates, directors, officers, employees, or agents acting in

their capacity as such for the period of the engagement and for a period of two years after the engagement.

6. In determining whether to accept the City's Offer, the Commission considered these undertakings and remediation measures.

#### IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in the City's Offer.

Accordingly, it is hereby ORDERED that:

A. The City cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; and

B. The City comply with the undertakings enumerated in paragraph 5 of Section III.F. above.

By the Commission.

Nancy M. Morris  
Secretary

# EXHIBIT 2



ATTORNEY TO CLIENT  
CORRESPONDENCE  
FOR CONFIDENTIAL USE ONLY

Office of  
The City Attorney  
City of San Diego

MEMORANDUM  
MS 59

(619) 236-6220

**DATE:** November 6, 2001  
**TO:** Honorable Mayor and Members of the City Council  
**FROM:** Leslie J. Girard, Assistant City Attorney  
**SUBJECT:** Furgatch v. San Diego Unified Port District, et al., Court of Appeal D035842;  
City, et al. v. All Persons Interested, et al., San Diego Superior GIC 763487;  
Dunkl v. City, et al., U.S. Supreme Court No. 01-136; Skane v. City, et al., San  
Diego Superior GIC 752505; and anticipated litigation matter: Henderson v. City

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In closed session we will be discussing with you your responsibilities regarding the consideration of the Preliminary Official Statement for the City's ballpark bonds. Our outside counsel, Gerald Boltz and Matt Anhut of Bryan Cave LLP, along with the City's bond counsel, Paul Webber of Orrick Herrington & Sutcliffe LLP, will be discussing these matters with you. Enclosed, for your review prior to the closed session, is a memorandum from Mr. Boltz and Mr. Anhut that generally outlines federal securities laws on this subject.

Enclosure

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October 29, 2001

Leslie J. Girard, Esq.  
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1200 Third Avenue, Suite 1620  
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**Privileged and Confidential**  
**Attorney-Client Communication**

Re: Review of Disclosure Documents as to Lease Revenue Bonds 2001

Dear Les:

We are writing this letter to provide an overview of the applicable federal securities laws and to provide a framework against which the City Council for the City of San Diego ("City Council") and the Board of Commissioners of the Public Facility Financing Authority of the City of San Diego ("Board of Commissioners") must review and evaluate the Preliminary Official Statement ("POS"), and the Official Statement when completed, prepared in anticipation of the offering of the Lease Revenue Bonds 2001 ("2001 Bonds"). As noted in the POS, the purpose of the bond offering is to finance the construction of a major league baseball park in San Diego, as well as other uses (as described in the POS) relating to the ballpark project (the "Ballpark Project"). In this letter we will not recount the lengthy history relating to the Ballpark Project and the numerous related legal challenges and actions, except to note, however, that in a letter dated September 20, 2001, to the City Attorney, the lawyer who has been the driving force behind various pieces of litigation relating to the Ballpark Project has contended that, because of various changes and alterations, the Ballpark Project should be re-submitted to the voters of San Diego for approval (the "September Letter").

In light of the application of provisions of the federal securities laws, and in particular the obligations imposed on issuers in connection the offering and sale of securities (as described below), and the allegations made in the September Letter, each member of the City Council and the Board of Commissioners must read the POS (and when completed the Official Statement), ask questions as to any area or matter that may seem unclear or need clarification, actively seek

Leslie J. Girard, Esq.  
October 29, 2001  
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information from the officials of the City or Authority and professionals retained in connection with the proposed offering, and conduct follow-up as to the information supplied.

Overview of the Applicable Federal Securities Laws

While Congress exempted offerings of municipal securities, such as the 2001 Bonds, from the registration requirements of the Securities Act of 1933, and the system of periodic reporting under the Securities Exchange Act of 1934, it did not exempt transactions in municipal securities from the antifraud provisions of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder. These provisions prohibit any person, including municipal issuers, from making a false or misleading statement of material fact, or omitting any material facts necessary to make statements made by that person not misleading, in connection with the offer, purchase or sale of any security. In the event of a violation of the securities provisions, the SEC has a range of remedies at its disposal, including the authority to seek injunctive relief to stop (in extraordinary circumstances) the offer or sale of securities and the imposition of penalties (which include monetary fines and the placement of limitations on securities related activities). In addition, there is typically a substantial amount of negative publicity that arises in connection with an SEC proceeding.

Although as to certain antifraud provisions, the SEC must show that the person acted with "scienter" -- that is recklessness or an intent to deceive, manipulate, or defraud -- the SEC need only demonstrate that the person acted negligently to establish a violation of other antifraud provisions. To establish negligence, the SEC must show that the defendants failed to conform with the standard of care that a reasonable person would have exercised in like circumstances and position. Of course, there must first be a misstatement or omission of a material fact; however, the lower threshold of negligence provides greater enforcement flexibility to the SEC.

In light of the foregoing, it is critical that the City Council and the Board of Commissioners exercise all due care in reviewing and evaluating the information contained in the POS. As to that information, the statements in the POS "must be viewed as part of a 'mosaic' to see if those statements, in the aggregate, created a misleading impression. . . . The proper test is not the literal truth or the materiality of each positive statement, but the overall misleading impression that it combines to create." *In re Genentech, Inc., Securities Litigation*, 1989, Fed. Sec. L. Rep. (CCH) ¶194, 544 (N.D. Cal. 1989). Moreover, a fact is deemed "material" if there is a " . . . substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable [investor]. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

Leslie J. Girard, Esq.

October 29, 2001

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Unfortunately, in the event that there is a challenge to the adequacy of a disclosure document, such challenge occurs with the benefit of hindsight. While it is not appropriate to apply hindsight, as a practical matter it is sometimes difficult to disregard subsequent events, and the impact of those events, in placing the disclosure in the proper context of what had occurred as of the time that the document was created.

The importance of the review of municipal securities disclosure documents was highlighted in connection with an SEC report that was critical of the supervisors of Orange County, California for shortcomings relating to their review of such documents. *Report of Investigation in the Matter of County of Orange, California as it Relates to the Conduct of the Members of the Board of Supervisors*, Exchange Act Release No. 36761 (January 24, 1996). As stated by the SEC in the Orange County matter:

In authorizing the issuance of securities and related disclosure documents, a public official may not authorize disclosure that the official knows to be false; nor may a public official authorize disclosure while recklessly disregarding facts that indicate that there is a risk that the disclosure may be misleading. When, for example, a public official has knowledge of facts bringing into question the issuer's ability to repay the securities, it is reckless for that official to approve disclosure to investors without taking steps appropriate under the circumstances to prevent the dissemination of materially false or misleading information regarding those facts. **In this matter, such steps could have included becoming familiar with the disclosure documents and questioning the issuer's officials, employees or other agents about the disclosure of those facts.**

*Id.* (emphasis added).

The message communicated by the statements of the SEC in the foregoing report is that members of the body approving disclosure documents cannot simply "rubber-stamp" the document. Rather, each member has the responsibility to demonstrate that he or she was actively involved in the process -- that is, each person must review the disclosure document, inquire as to the source of the information, ask questions of the City officials and other professionals who provided information (as well as ask if there are other sources of information that should be reviewed), and follow-up to ascertain whether the information makes sense in the circumstances. In short, the members of the City Council and the Board of Commissioners must demonstrate that they have satisfied themselves, after diligent inquiry that all material facts have been accurately disclosed, that the POS is not misleading.

#### Application of the Provisions of Federal Securities Laws to the POS

As discussed above, the primary consideration in regard to the POS is that it not contain a misstatement as to a material fact or omit to state any fact that is necessary so as to make the

BRYAN CAVE LLP

Leslie J. Girard, Esq.

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statements contained therein not misleading. This standard does not mean that the members of the City Council and the Board of Commissioners cannot rely on the professionals and City officials who have supplied information to be included in the POS. What it does mean, however, is that the members of the City Council and the Board of Commissioners act with reasonable care. This includes, at a minimum: (1) reviewing the entire POS; (2) asking for clarification as to material parts of the POS that a member may need additional guidance; (3) seeking information and asking questions of the officials, employees, and professionals who supplied information to be included in the POS; and (4) asking follow up questions to determine the reasonableness of any assumptions or estimates that were used in the POS. Although significant efforts have been expended to make the information in the POS accurate and understandable, the members of the City Council and the Board of Commissioners should not be hesitant to inquire as to any area that might not be entirely clear.

Also, in light of prior challenges to the Ballpark Project, it is prudent that the City Council make certain that there are no additional disclosure issues that need to be addressed. In particular, the City Council should document whether there is any potential conflict of interest -- whether through a business or financial relationship or transaction -- that might need to be disclosed. In this regard, we recommend that the City Council document that each member has not received anything of value from the Padres, any affiliate of the Padres, or any other person or entity that has a material interest in either the Ballpark Project or the proposed offering of the 2001 Bonds. (Such persons include: Padres, L.P.; Padres Construction, L.P.; Mr. John Moores; JMI Realty, Inc.; JMIR - Downtown Acquisition, LLC; San Diego Ballpark Builders; Clark Construction Group, Inc.; Nielsen Dillingham Builders; Douglas E. Barnhart, Inc.; Hines Interests Limited Partnership; Major League Baseball; Ambac Assurance Corporation; Wells Fargo Corporate Trust; HOK Sports; Merrill Lynch & Co., Inc.; Morgan Stanley & Co., Inc.; I.C. Rideau Lyons & Co.; Redwood Securities Group.)

From the perspective of the securities laws, no precise criteria can be established as to the level or range of financial and business relationships, arrangements and practices that might be problematic. The better practice is to ensure that there is no potential conflict in the first instance by requesting and obtaining written confirmation from each member that he or she did not have any business or financial dealings with any person who might be interested in the Ballpark Project or the 2001 Bond offering.

Finally, the City Council should, as part of its review, address the allegations made in the September Letter. In particular, in the September Letter, the lawyer asserts that changes in the financing and revenue assumptions relating to the Ballpark Project and the ancillary development; the increase in the financial participation by the Redevelopment Agency, the reliance by the City on other revenue sources for the Ballpark Project, any amendments to the MOU, and the change in the scope of the ancillary development mandate that the project again be submitted to the voters of the City for approval. Further, and notwithstanding that the POS had

BRYAN CAVE LLP

Leslie J. Girard, Esq.

October 29, 2001

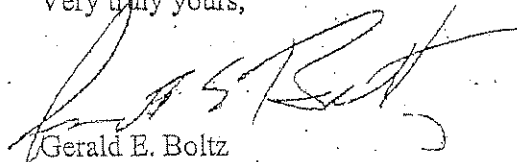
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not been completed or released prior to the date of his letter, the lawyer stated that matters might be "omitted or misstated in the [POS]."

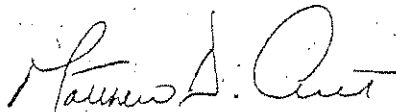
In regard to the allegations made by in the September Letter, portions of the POS relating to the Plan of Financing, the Redevelopment Project, the Risk Factors and Litigation should receive additional attention on review by the City Council and the Board of Commissioners. In particular, the lawyer asserts that the transient occupancy tax and tax increment to be generated from the hotels, office space and other development around the Ballpark Project will not be sufficient to pay for the City's contribution to the Ballpark Project. While the assertion rests upon the assumption that specific revenues were pledged for the project, the allegations highlight the importance of reviewing the financial projections and assumptions underlying the City's commitment and resources available to repay the bonds. In that regard, the members of the City Council and the Board of Commissioners should make use of the resources available through City officials in determining whether any of the assertions warrant further attention.

Although there can be no prediction of what future actions might be brought relating to the Ballpark Project or the offering of the 2001 Bonds, a thorough and careful review of the POS by the members of the City Council and the Board of Commissioners will provide a solid foundation to support any response to -- and hopefully summarily conclude -- potential, future challenges.

Very truly yours,



Gerald E. Boltz



Matthew D. Anhut



# EXHIBIT 3

## SEC NEWS DIGEST

Issue 2006-92

May 12, 2006

## COMMISSION ANNOUNCEMENTS

## COMMISSION NOTES PASSING OF GERALD BOLTZ

The Commission is saddened to learn that former colleague Gerald E. Boltz died in Santa Monica, California, on May 10, 2006. Mr. Boltz was a highly-regarded Enforcement Division official who held several senior positions during his 20-year career at the agency, retiring in 1979 after seven years as regional administrator of the SEC's Los Angeles Regional Office. Previously, Mr. Boltz was regional administrator of the Fort Worth Regional Office from 1967 to 1971; chief trial counsel for the Denver Regional Office from 1961 to 1967; and legal assistant to Commissioner Daniel J. McCauley and member of the Special Investigations Unit from 1959 to 1961. Mr. Boltz served as assistant attorney general for the State of Ohio from 1958 to 1959. Following his government service, Mr. Boltz engaged in the private practice of law in California. He retired as a partner in the Santa Monica, California, office of Bryan Cave in December of 2004 where he held various administrative positions during his 12 years with the firm.

## ENFORCEMENT PROCEEDINGS

## TERRY HARRIS BARRED FROM INVESTMENT ADVISER BUSINESS

Terry Harris (Harris) has been barred from association with any investment adviser, whether registered with the Securities and Exchange Commission or unregistered. The sanction was ordered in an administrative proceeding before an administrative law judge and was based on Harris's Alabama state felony conviction for transacting business as an investment adviser representative without being registered with the state. Harris has also been prohibited by the State of Illinois from selling securities in that state. (Initial Decision Rel. No. 311; File No. 3-12171)

## SEC BARS FORMER REGISTERED REPRESENTATIVE KONSTANTINE DRAKOPOULOS BASED ON CRIMINAL CONVICTION

On May 11, the Commission issued an Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions (Order) against Konstantine Drakopoulos (Drakopoulos). The Order finds that on Aug. 9, 2002, Drakopoulos pled guilty to one count of conspiracy to commit securities fraud in violation of 15 U.S.C. §§ 78j(b) and 78ff, and that on March 17, 2006, a judgment of conviction was entered against him (See U.S. v. Konstantine Drakopoulos, 02-CR-504, EDNY).

The indictment against Drakopoulos and others was filed on April 29, 2002. Count One of the indictment, to which Drakopoulos pled guilty, alleged that, during September 2000, Drakopoulos conspired with others to commit securities fraud by, among other things, providing material, non-public information about a pending merger of WLR Foods, Inc. (WLRF) to co-conspirators for the purpose of causing them to purchase shares of WLRF prior to the public announcement of the merger. The indictment also alleged that Drakopoulos paid cash in exchange for the material, non-public information.

The Order bars Drakopoulos from association with any broker or dealer. Drakopoulos consented to the issuance of the Order without admitting or denying any of the findings in the Order. (Rel. 34-53792; File No. 3-12293)

## COMMISSION REMANDS NASD'S DENIAL OF APPLICATION BY MAY CAPITAL GROUP, LLC TO EMPLOY MELVIN ROKEACH



# EXHIBIT 4

Westlaw.

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City of San Diego v. Furgatch

Cal.App. 4 Dist., 2002.

Only the Westlaw citation is currently available. California Rules of Court, rule 977(a), prohibits courts and parties from citing or relying on opinions not certified for publication or ordered published, except as specified by rule 977(b). This opinion has not been certified for publication or ordered published for purposes of rule 977.

Court of Appeal, Fourth District, Division 1,  
California.

CITY OF SAN DIEGO et al., Plaintiffs, Cross-  
Defendants and Respondents,

v.

Harvey FURGATCH, Defendant, Cross-  
Complainant and Appellant.

Edward TEYSSIER, Defendant and Appellant.  
Bruce Skane et al., Plaintiffs and Appellants,

v.

City of San Diego et al., Defendants and  
Respondents.

Public Facilities Financing Authority of the City of  
San Diego et al., Real Parties in Interest and  
Respondents.

**Nos. D038587, D038751, D038879.**

**(Super.Ct.Nos. GIC763487, GIC752505).**

July 17, 2002.

As Modified Aug. 7, 2002.

City and its redevelopment agency, seeking protection from future conflict of interest challenges predicated upon city council member's failure to report gifts from majority owner of private limited partnership which owned major league baseball team, brought in rem action for judicial declaration of validity of city council's ratification of agreements between city, agency, and partnership, relating to downtown redevelopment project which included major league baseball park. Challengers sought to stop the project, based on the city council member's conduct in failing to report the gifts from partnership's majority owner. The Superior Court, San Diego

County, Nos. GIC763487, GIC752505, Judith D. McConnell and E. Mac Amos, JJ., granted summary judgment for city and agency in the validation action, sustained without leave to amend city's demurrer to challengers' conflict of interest causes of action, and granted summary judgment for city as to challengers' cause of action alleging that interim funding resolution violated city charter. Challengers appealed. The Court of Appeal, McIntyre, J., held that: (1) city provided adequate notice of intended scope of validation action; (2) city council member had prohibited financial interest in city's contracts, for purposes of conflict of interest statute for public officials; and (3) city could ratify the contracts.

Affirmed.

West Headnotes

**[1] Municipal Corporations 268 ⇌ 297(1)**

268 Municipal Corporations

268IX Public Improvements

268IX(B) Preliminary Proceedings and  
Ordinances or Resolutions

268k297 Remonstrances or Objections

268k297(1) k. In General. Most Cited

Cases

City provided adequate notice of intended scope of its in rem action for judicial declaration of validity of city council's ratification of agreements between city, city redevelopment agency, and private limited partnership which owned major league baseball team, relating to downtown redevelopment project which included major league baseball park, though validation complaint, city council and agency resolutions incorporated into complaint, and summons for publication failed to specifically identify city and agency resolutions by date or title and failed to specifically identify downtown redevelopment contracts by description, date, or title; complaint, incorporated resolutions, and published summons set forth reasonably detailed factual background summarizing the parties, passage of voter-approved proposition, memorandum of understanding (MOU) and related

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contracts, the project, and allegations regarding city council member's failure to report gifts from partnership's majority owner, which prompted city council to ratify the agreements and to seek, through validation action, protection from future conflict of interest challenges predicated upon city council member's conduct. West's Ann.Cal.C.C.P. § 861.1; West's Ann.Cal.Gov. Code §§ 1090, 1092.

## **[2] Declaratory Judgment 118A ⇌255**

118A Declaratory Judgment  
 118AIII Proceedings  
 118AIII(A) In General  
 118Ak255 k. Limitations and Laches.  
 Most Cited Cases

## **Municipal Corporations 268 ⇌917(2)**

268 Municipal Corporations  
 268XIII Fiscal Matters  
 268XIII(C) Bonds and Other Securities, and Sinking Funds  
 268k917 Proceedings Preliminary to Issue of Bonds  
 268k917(2) k. Determination of Validity. Most Cited Cases  
 City's in rem action for judicial declaration of validity of city council's ratification of agreements between city, city redevelopment agency, and private limited partnership which owned major league baseball team, relating to downtown redevelopment project which included major league baseball park, was timely under 60-day limitations period for validation action, though action was brought more than 60 days after city's approval of bond contracts and other agreements relating to the project; city was not seeking direct validation of bond contract and other agreements, but instead, city, in response to allegations regarding city council member's failure to report gifts from partnership's majority owner, ratified the bond contract and agreements and sought, through validation action, protection from future conflict of interest challenges predicated upon city council member's conduct, and city filed the validation action within 60 days of passage of ratification acts.

West's Ann.Cal.C.C.P. § 860; West's Ann.Cal.Gov. Code §§ 1090, 1092.

## **[3] Declaratory Judgment 118A ⇌329**

118A Declaratory Judgment  
 118AIII Proceedings  
 118AIII(D) Pleading  
 118Ak329 k. Issues, Proof and Variance.  
 Most Cited Cases

## **Municipal Corporations 268 ⇌297(1)**

268 Municipal Corporations  
 268IX Public Improvements  
 268IX(B) Preliminary Proceedings and Ordinances or Resolutions  
 268k297 Remonstrances or Objections  
 268k297(1) k. In General. Most Cited Cases

City's in rem action for judicial declaration of validity of city council's ratification of agreements between city, city redevelopment agency, and private limited partnership which owned major league baseball team, relating to downtown redevelopment project which included major league baseball park, did not preclude challengers from asserting the city charter as an affirmative defense to validation of ratification acts, though city's validation complaint and summons for publication purported to limit the scope of the action to protection from future conflict of interest challenges predicated upon city council member's failure to report gifts from partnership's majority owner; city could not use technical pleading to limit challenges by interested parties. West's Ann.Cal.C.C.P. §§ 860, 861.1, 862; West's Ann.Cal.Gov. Code §§ 1090, 1092.

## **[4] Municipal Corporations 268 ⇌351**

268 Municipal Corporations  
 268IX Public Improvements  
 268IX(C) Contracts  
 268k349 Unauthorized or Illegal Contracts  
 268k351 k. Ratification. Most Cited Cases

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Memorandum of understanding (MOU) authorizing city and city redevelopment agency to enter into agreements with private limited partnership which owned major league baseball team, relating to downtown redevelopment project which included major league baseball park, was not invalidated by city council member's alleged conflict of interest in negotiating with her city council colleagues regarding the MOU while city council member was receiving undisclosed gifts from partnership's majority owner, where city electorate independently approved the MOU by adopting it as ballot proposition; even if every vote of city council before voters adopted the proposition was void, voters' adoption of that measure expunged city's disability to act and rendered the MOU a valid obligation of city. West's Ann.Cal.Gov. Code §§ 1090, 1092.

#### [5] Municipal Corporations 268 ⇌ 297(1)

268 Municipal Corporations  
 268IX Public Improvements  
 268IX(B) Preliminary Proceedings and Ordinances or Resolutions  
 268k297 Remonstrances or Objections  
 268k297(1) k. In General. Most Cited

##### Cases

Scope of statutory validation action for city contracts, in which city sought judicial declaration of validity of city council's ratification of agreements between city, city redevelopment agency, and private limited partnership which owned major league baseball team, relating to downtown redevelopment project which included major league baseball park, included memorandum of understanding (MOU) between city, agency, and partnership, land acquisition and management agreements, design and construction agreements, settlement and planning agreements relating to design and construction process, and purchase and sale agreement for parking lots; if such contracts were void, then city's lease revenue bonds would not be marketable and the project's financing would collapse. West's Ann.Cal.C.C.P. § 860 et seq.; West's Ann.Cal.Gov. Code § 53511.

#### [6] Municipal Corporations 268 ⇌ 351

268 Municipal Corporations  
 268IX Public Improvements  
 268IX(C) Contracts  
 268k349 Unauthorized or Illegal Contracts  
 268k351 k. Ratification. Most Cited

##### Cases

City, in response to allegations regarding city council member's failure to report gifts from majority owner of private limited partnership which owned major league baseball team, could ratify city's contracts regarding downtown redevelopment project which included major league baseball park, where city council member's resignation removed the disability, relating to conflict of interest during negotiation of contracts, which may have precluded the validity of the contracts. West's Ann.Cal.Gov. Code §§ 1090, 1092.

#### [7] Municipal Corporations 268 ⇌ 297(2)

268 Municipal Corporations  
 268IX Public Improvements  
 268IX(B) Preliminary Proceedings and Ordinances or Resolutions  
 268k297 Remonstrances or Objections  
 268k297(2) k. Withdrawal of Protest. Most Cited

##### Cases

City council was rebuttably presumed to have regularly adopted acts ratifying contracts for downtown redevelopment project which included major league baseball park, and thus, the burden was on challengers, in city's in rem action for judicial validation of the ratification acts, to show that a city council member had a conflict of interest regarding adoption of the ratification acts. West's Ann.Cal.C.C.P. § 860 et seq.; West's Ann.Cal.Evid. Code §§ 660, 664.

#### [8] Municipal Corporations 268 ⇌ 297(1)

268 Municipal Corporations  
 268IX Public Improvements  
 268IX(B) Preliminary Proceedings and Ordinances or Resolutions  
 268k297 Remonstrances or Objections

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268k297(1) k. In General. Most Cited Cases

Trial court's error was harmless, in severing, from city's in rem action for judicial declaration of validity of city council's ratification of agreements relating to downtown redevelopment project which included major league baseball park, challenger's cross-complaint alleging the invalidity of city ordinances, resolutions, and contracts relating to the project, though city's action and challenger's cross-complaint involved common issues, the statute authorizing the in rem validation proceeding required consolidation of all challenges, and entry of separate "judgments" for in rem action and cross-complaint created interlocutory judgment which was not immediately appealable; entire matter was litigated and brought to complete disposition in expedited fashion, and entire validation matter was judicially resolved upon filing of second "judgment," rendering the aggregate substantive effect of the two "judgments" to be one single final one, with premature notices of appeal from "first judgment" having been filed at earliest permissible time. West's Ann.Cal.C.C.P. §§ 865, 869, 870, subd. a; Cal.Rules of Court, Rule 2(d).

#### [9] Appeal and Error 30 ⇌ 1079

30 Appeal and Error

30XVI Review

30XVI(K) Error Waived in Appellate Court

30k1079 k. Insufficient Discussion of Objections. Most Cited Cases

Challenger to city's ratification of agreements, relating to downtown redevelopment project which included major league baseball park, abandoned appellate review of claim that trial court's grant of injunctive relief to city violated challenger's constitutional right to petition the government, where challenger's appellate brief provided a conclusory and insufficient discussion of the claim, relying on two general case citations without any meaningful and fruitful argument in support of the claim. U.S.C.A. Const.Amend. 1; West's Ann.Cal.C.C.P. § 870.

#### [10] Municipal Corporations 268 ⇌ 279

268 Municipal Corporations

268IX Public Improvements

268IX(A) Power to Make Improvements or Grant Aid Therefor

268k279 k. Submission of Question to Popular Vote. Most Cited Cases

City council's acts ratifying agreements for downtown redevelopment project that included major league baseball park did not constitute the "adoption" of a major public project, within meaning of city charter provision requiring a public vote of city electorate to approve a major public project; the ratified agreements were merely implementing agreements, rather than agreements adopting a project.

#### [11] Municipal Corporations 268 ⇌ 297(1)

268 Municipal Corporations

268IX Public Improvements

268IX(B) Preliminary Proceedings and Ordinances or Resolutions

268k297 Remonstrances or Objections

268k297(1) k. In General. Most Cited Cases

City's alleged noncompliance with city charter provision allegedly requiring disclosure of business interests of all parties to the transaction was not an affirmative defense available to challenger, in city's in rem action for judicial declaration of validity of city council's ratification of agreements between city, city redevelopment agency, and private limited partnership which owned major league baseball team, relating to downtown redevelopment project which included major league baseball park; to extent that the provision granted city council discretion to decide whether future disclosures should or should not be required, court was not in position to dictate that such discretion should be exercised in any particular way, the provision did not appear to have been adopted to create private right of action for disgruntled citizens to torpedo measures with which they disagreed, and challenger's affirmative defense was a belated attempt to challenge the underlying contracts.



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West's Ann.Cal.C.C.P. § 860 et seq.

**[12] Municipal Corporations 268 ⇌ 231(2)**

268 Municipal Corporations

268VII Contracts in General

268k231 Individual Interest of Officer

268k231(2) k. Public Improvements. Most

Cited Cases

City council member had a prohibited financial interest, for purposes of conflict of interest statute for public officials, as to city's contracts with private limited partnership which owned major league baseball team, relating to downtown redevelopment project which included major league baseball park, where council member expected present and future gratuities from partnership in exchange for negotiation, and city council's adoption and implementation, of contracts favorable to partnership's financial interests. West's Ann.Cal.Gov. Code § 1090.

**[13] Municipal Corporations 268 ⇌ 890**

268 Municipal Corporations

268XIII Fiscal Matters

268XIII(B) Administration in General,  
 Appropriations, Warrants, and Payment

268k889 Appropriations

268k890 k. Making and Requisites.

Most Cited Cases

City charter did not require city manager's written recommendation for city council's appropriation of interim funding until issuance of lease revenue bonds for downtown redevelopment project which included major league baseball park; while city charter contemplated guiding and accountability roles for city manager in budget adoption process, it was city council that adopted annual appropriations ordinance, and council could amend it at any time during fiscal year, like any other ordinance.

APPEALS from judgments of the Superior Court of San Diego County, Judith D. McConnell and E. Mac Amos, Judges. Affirmed.  
 McINTYRE, J.

\*1 These consolidated appeals represent the latest

chapter in the continuing litigation spawned by the downtown redevelopment project that includes the building of a major league baseball ballpark in the City of San Diego (the City). The present controversy arises from the conduct of former city council member **Valerie Stallings**, who resigned from the city council and pleaded guilty to failing to report gifts received from John Moores, the majority owner of the **San Diego** Padres Baseball Club (the Padres), the private limited partnership developing the ballpark and certain ancillary elements of the project in conjunction with the City and the Redevelopment Agency of the City of **San Diego** (the Agency). Confronted by claims that Stallings's conduct rendered critical project finance and related contracts void thus halting development, the city council reconsidered the value of the project as a whole to the City and the Agency and passed an ordinance and two resolutions (Ratification Acts) ratifying as of the date of their initial making Agency's adoption of the Memorandum of Understanding (the MOU) between the City, the Agency and the Padres, and related contracts and agreements implementing it. The City and the Agency then filed an in rem action to validate the Ratification Acts under Code of Civil Procedure section 860 et sequel, seeking a judicial declaration the MOU and all related contracts and agreements to which the Ratification Acts apply, are valid and binding upon the City and the Agency and not subject to further challenge under Government Code sections 1090 and 1092. (All statutory references are to the Government Code unless otherwise specified.) Two of these appeals, D038587 and D038751, arise directly from the trial court's entry of summary judgment on behalf of the City and the Agency in their validation action against interested parties, Harvey Furgatch and Edward Teyssier. The remaining appeal, D038879, in *Skane v. City of San Diego, et al.*, arises from an attempt by Bruce Skane and Jerry Mailhot to stop the downtown redevelopment project because of **Stallings's** conduct. The trial court dismissed their second amended complaint after sustaining the City's demurrer to their sections 1090 and 1092 cause of action without leave to

amend and granting its motion for summary judgment as to their cause of action alleging the interim funding resolution violated the City Charter.

In the validation action appeals, we conclude the trial court correctly overruled Furgatch's demurrers for uncertainty and on statute of limitations grounds. We hold that the City and the Agency's validation complaint as to the Ratification Acts necessarily included any challenge based on City Charter section 94 arising from Stallings's misconduct. Further, we conclude the MOU as a City contract was not vulnerable to challenge under either the Government Code or the City Charter; the Ratification Acts are subject to the "Validation Law"; summary judgment was proper because as a matter of law, void contracts under sections 1090 and 1092 and City Charter section 94 can be legally ratified; summary judgment was correctly entered on Furgatch's cross-complaint; and the remaining miscellaneous contentions regarding the summary judgment process and the sustaining of the demurrer without leave to amend to Teyssier's affirmative defenses are without merit. In the *Skane* appeal, we conclude that Stallings's conduct and relationship with the Padres as alleged gave rise to a prohibited financial interest under section 1090 and City Charter section 94, but that our affirmance of the validity of the Ratification Acts rendered moot those causes of action within the second amended complaint. Finally, we conclude the trial court properly granted summary judgment on their causes of action asserting the interim funding resolution violated the City Charter. Accordingly, we affirm the judgments.

#### FACTUAL AND PROCEDURAL BACKGROUND

\*2 On November 3, 1998, the City electorate approved Proposition C, which authorized the City to enter into various agreements, including the MOU, governing the construction of a downtown major league baseball ballpark and redevelopment project by a 60 percent to 40 percent margin. The proposition and the MOU provide for a public-private partnership between the Padres, the City

and redevelopment entities to build a new ballpark as part of the larger redevelopment project in Centre City East in downtown San Diego. After the election, the City, the Agency, the Centre City Development Corporation (the CCDC) and the Padres executed the MOU. (*City of San Diego v. Dunkl* (2001) 86 Cal.App.4th 384, 389-390, 103 Cal.Rptr.2d 269.) Additionally, the city council adopted ordinances, city resolutions, and Agency resolutions designed to implement the MOU and related redevelopment plans. These public acts approved contracts for goods, services, financing, as well as agreements and amendments to agreements with the Padres as authorized by the MOU. Resolution No. R-291450, entitled "Sufficient Assurances Resolution," adopted on March 31, 1999 (sufficient assurances resolution) made findings required by the MOU, including that the Padres had provided the City with sufficient assurances concerning ancillary development and other projects, and accepted a first priority lien on the Padres's major league franchise pursuant to the terms and conditions of the attached security agreement. On January 31, 2000, Ordinance No. O-18747 and Resolution No. R-292697 were adopted, providing that the City would finance its investment under the MOU by lease revenue bonds, authorizing the underwriting agreement for the bonds and approving issuing bonds up to \$299,000,000 by the Public Facilities Financing Authority of the City of San Diego (the PFFA) to finance the City's investment and the bond contracts necessary for their issuance.

In response to a **SanDiego** Union Tribune news article disclosing that city council member **ValerieStallings** had profited from investing in the initial public offering of stock of a corporation related by partial common ownership to the Padres, the United States Attorney and the **SanDiego** County District Attorney jointly investigated the financial relationships between persons and entities related to the Padres and City officials, specifically **Stallings**. On January 29, 2001, Stallings resigned from the city council and pleaded guilty to two misdemeanor charges of knowingly failing to disclose gifts in excess of the disclosure threshold

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in violation of sections 87207 and 91000, and knowingly attempting to use her official position to influence governmental decisions in which she had a financial interest, in violation of sections 87100 and 91000. Within the addendum to her plea form, she admitted receiving, but not reporting under the Political Reform Act of 1974, Title 9 of the Government Code, gifts from the majority owner of the Padres, John Moores. Specifically, during the period between 1996 and 1999, she admitted that Moores and the Padres gave her and members of her family gifts in excess of the monetary limit set forth in section 89503. She further acknowledged that during 1998 and 1999, she participated in making multiple governmental decisions materially affecting Moores and the Padres, including the February 23, 1998 vote for the City to participate in financing the new ballpark; the March 24th vote placing the ballpark proposition before the San Diego electorate in November 1998; the June 16th vote defeating a motion to increase the Padres' ballpark financing contribution to \$150 million; the March 31, 1999 vote in favor of finding the Padres and others had provided sufficient assurances for meeting their obligations for the project to continue; the October 26th vote approving the environmental impact report regarding the ballpark and related development; and the December 14th vote authorizing the sale of approximately \$299 million in municipal bonds and defeating a motion to delay the measure until questions raised by other city council members could be answered.

\*3 On February 20, 2001, the city council ratified project-related contracts pertaining to the development of the Westin Hotel in the ballpark district. On March 6, it adopted a City ordinance, a City resolution and an Agency resolution (the Ratification Acts), in which it validated, ratified and approved, as of the date of their initial making, the MOU (as an Agency contract) and all other contracts and agreements made to implement Proposition C. The Ratification Acts were adopted expressly "to put to rest any doubt about the validity of the actions authorizing" the relevant downtown redevelopment contracts in the light of the "alleged conflicts of interest on the part of

[Stallings]." Specifically, City Ordinance No. O-18927 re-adopted, validated or ratified as necessary City Ordinance No. O-18747 to reaffirm its validity and that of the contracts and agreements authorized by it. Similarly, City Resolution No. R-294638 provided:

"BE IT RESOLVED, by the Council of the City of San Diego that the following resolutions [Resolutions] are hereby re-adopted, validated or ratified as necessary to reaffirm their validity, and the validity of the contracts and agreements authorized by them, commencing with their respective times of adoption, and to effectuate their continuing validity, and the continuing validity of the contracts and agreements authorized by them: Nos.R-292006; R-292298; R-292441; R-292333; R-292615; R-292697; R-292698; R-292699; R-292700;R-292701; R-292702; R-292703; R-292706; R-292707; R-292800; R-293854; R-294389."

Utilizing similar language, Agency Resolution No. R-03306 re-adopted, validated or ratified as necessary specifically numbered Agency resolutions. The sufficient assurances resolution was specifically addressed by City Resolution No. R-294638, which employed the same language above to ratify specifically numbered City resolutions. Further, it ratified the prior act of the city council in approving the security documents on the Padres's franchise without restating the findings made on March 31, 1999. The City resolution expressly waived satisfaction of the conditions and other circumstances in the event the sufficient assurances resolution, or any part of it, is judicially invalidated.

On March 7, the City and the Agency filed a validation action pursuant to Code of Civil Procedure section 860, et sequel, seeking judicial validation, approval and confirmation of the Ratification Acts. Moreover, the complaint sought a judicial declaration the MOU (as an Agency contract) and all other contracts and agreements to which the Ratification Acts apply, are valid and binding upon the City, the Agency and the PFFA insofar as being duly adopted not subject to further



challenge under section 1092. The complaint did not seek validation of any ordinance, resolution or contract on substantive grounds; but rather, only sought to protect such acts from future conflict of interest challenges predicated upon the alleged wrongful acts of Stallings. The City and the Agency obtained the next day an order for publication of summons as required by Code of Civil Procedure section 861, setting April 16, 2001, as the last day any interested party might appear in the validation action and contest the legality or validity of the matters alleged therein. On that day, Furgatch and Teyssier responded to the complaint. Furgatch demurred specially on the grounds of uncertainty and ambiguity, and generally on statute of limitations grounds, at least as to any attempt to validate the bond contracts. Teyssier's answer denied many of the factual allegations within the complaint and asserted various affirmative defenses. The City and the Agency demurred to six of Teyssier's affirmative defenses. Following response and oral argument, the trial court sustained without leave to amend the demurrer, expressly finding the validation action is limited to the issue of whether the City and the Agency properly ratified the downtown redevelopment legislation such that it is not subject to challenge under sections 1090 and 1092 because of the alleged conflict of interest of Stallings. The trial court further found that the City and the Agency were not seeking to validate the downtown redevelopment legislation against challenges brought under the California Environmental Quality Act (CEQA), the City Charter, or the MOU, which have been previously adjudicated by this court and others.

\*4 The City and the Agency moved for summary judgment. Teyssier and Furgatch opposed the motion, arguing respectively the right to discovery under Code of Civil Procedure section 437c, subdivision (h), and that the court could not hear the motion until Furgatch filed his answer, which had not been filed pending the outcome of his demurrers. The trial court overruled Furgatch's special and general demurrers and ordered him to file his answer and affirmative defenses. Furgatch

answered, filed his affirmative defenses, and cross-complained against the City and the Agency, alleging the MOU and certain specifically identified ordinances, resolutions, contracts and agreements were void under City Charter section 94 and sections 1090 and 1092. He alleged that Stallings maintained a personal financial relationship with the Padres, receiving various gifts in return for her actions to actively further the economic interests of the Padres, and was promised and expected to receive similar future economic benefits so long as she continued to further the Padres' economic interests in the MOU and related contracts and agreements. City Charter section 94 prohibits any elected or appointed City officer from becoming directly or indirectly interested in, or in the performance of, a contract with the City and declares that all contracts entered in violation of that section shall be void and unenforceable against the City. On June 28, the trial court granted the City and the Agency's motion for summary judgment. It held the downtown redevelopment contracts are as a matter of law an integrated project subject to the Validation Law; their ratification was untainted by any alleged conflict of interest from the circumstances relating to Stallings; and the City and the Agency had properly and legally ratified the acts of the prior city council by re-adopting the subject contracts, resolutions and ordinances by the new city council, absent votes from Stallings. The court further severed Furgatch's cross-complaint from the main action. Judgment was entered on June 29. Furgatch moved for reconsideration or alternatively to vacate the judgment. On August 9, the trial court granted the City and the Agency's motion for summary judgment on the cross-complaint, concluding it is barred by Code of Civil Procedure sections 863 and 869 and Furgatch had failed to sustain his burden of proof on summary judgment. Because Furgatch had filed his notice of appeal, the trial court declined to rule on his motion for reconsideration and took the matter off calendar. Both Teyssier and Furgatch timely appealed.

Before the City and the Agency filed their validation action, Skane and Mailhot filed a

complaint on August 7, 2000, against the City and other City-related entities alleging their business transactions with the Padres were void due to prohibited conflicts of interest in an attempt to stop the downtown redevelopment project based on the alleged conduct of Stallings. After a series of demurrers were sustained with leave to amend, they filed a second amended complaint on February 16, 2001, alleging that many of the City and the Agency contracts were void under sections 1090 and 1092 because Stallings had violated section 1090. The allegations parroted Stallings's guilty plea, but essentially averred she and Padres majority owner John Moores had a quid pro quo arrangement. The complaint also alleged that the interim funding resolution, City Resolution No. R-293552, for the project was invalid under the City Charter. The trial court dismissed the matter after sustaining the City's demurrer without leave to amend to the sections 1090 and 1092 cause of action and granting its motion for summary judgment on the causes of action challenging the interim funding resolution. As to the former, the trial court acknowledged that Skane and Mailhot do not contend that any city council members had a direct interest in the contracts involved, but rather that they had an indirect interest because they received gifts and had an expectation of future gifts in exchange for voting in favor of contracts that would benefit Moores, the Padres and JMI Realty, Inc. The court concluded that neither the gifts nor the expectation of future ones were "based on the contract" and thus did not constitute an interest in the outcome giving rise to an indirect interest within the meaning of sections 1090 and 1092. It expressly found that plaintiffs had not and could not allege facts showing that city council members would have received financial benefits from the contracts themselves. Skane and Mailhot timely appealed.

#### THE VALIDATION ACTION APPEALS

##### THE TRIAL COURT CORRECTLY OVERRULED FURGATCH'S DEMURRERS FOR UNCERTAINTY AND ON STATUTE OF LIMITATIONS GROUNDS

\*5 [1][2] Furgatch contends the trial court erred as a matter of law when it overruled his demurrers for uncertainty under Code of Civil Procedure section 430.10, subdivision (f) and on statute of limitations grounds under Code of Civil Procedure section 860. Regarding his special demurrer for uncertainty, he contends the validation complaint is so uncertain and ambiguous that no interested citizen could possibly be put on sufficient notice as to what governmental action it specifically intended to have validated. He asserts that by his demurrer he simply sought that the matters for which validation was sought be specifically identified. As to his general demurrer on statute of limitations grounds, he argues that the validation action violates the 60-day bar of Code of Civil Procedure section 860-at least in regard to the bond contracts that were approved on January 31, 2000. As we shall explain, neither contention has merit.

A demurrer tests the sufficiency of the complaint. (*Hernandez v. City of Pomona* (1996) 49 Cal.App.4th 1492, 1497, 57 Cal.Rptr.2d 406.) On appeal, under these circumstances where the trial court overruled the demurrer and Furgatch now seeks its review on appeal from the final judgment (*San Diego Gas & Electric Co. v. Superior Court* (1996) 13 Cal.4th 893, 912-913, 55 Cal.Rptr.2d 724, 920 P.2d 669), or following the trial court's sustaining of a demurrer without leave to amend, we examine the complaint and the demurrer de novo, to determine whether the complaint alleges facts sufficient to state a cause of action under any legal theory, or here, whether it is sufficiently detailed to put any interested party on reasonable notice as to what governmental action it seeks to validate. (See *McCall v. PacifiCare of Cal., Inc.* (2001) 25 Cal.4th 412, 415, 106 Cal.Rptr.2d 271, 21 P.3d 1189; *Quelimane v. Stewart Title Guaranty Co.* (1998) 19 Cal.4th 26, 38-39, 77 Cal.Rptr.2d 709, 960 P.2d 513.) In doing so, "we give the complaint a reasonable interpretation, reading it as a whole and its parts in their context." (*Blank v. Kirwan* (1985) 39 Cal.3d 311, 318, 216 Cal.Rptr. 718, 703 P.2d 58; *Adelman v. Associated Internat. Ins. Co.* (2001) 90 Cal.App.4th 352, 359, 108 Cal.Rptr.2d 788.) However, a demurrer for

uncertainty is strictly construed, even where the challenged complaint is in some respects vague and ambiguous. (*Khoury v. Maly's of California, Inc.* (1993) 14 Cal.App.4th 612, 616, 17 Cal.Rptr.2d 708.) In other words, "under our liberal pleading rules, where the complaint contains substantive factual allegations sufficiently apprising defendant of the issues it is being asked to meet, a demurrer for uncertainty should be overruled or plaintiff given leave to amend." (*Williams v. Beechnut Nutrition Corp.* (1986) 185 Cal.App.3d 135, 139, fn. 2, 229 Cal.Rptr. 605.)

Preliminarily, Code of Civil Procedure section 860 et sequel authorizes public agencies or interested persons to bring validation proceedings. Such proceedings are in rem. (*Bernardi v. City council* (1997) 54 Cal.App.4th 426, 439, 63 Cal.Rptr.2d 347; Code Civ. Proc., § 860.) " '[T]he purpose of the validation statutes is to provide a simple and uniform method for testing the validity of governmental action.' " (*Embarcadero Mun. Improvement Dist. v. County of Santa Barbara* (2001) 88 Cal.App.4th 781, 789, 107 Cal.Rptr.2d 6, quoting *Moorpark Unified School Dist. v. Superior Court* (1990) 223 Cal.App.3d 954, 960, 273 Cal.Rptr. 18.) The validation process is designed to obtain a speedy and complete determination of the validity of a public entity's action, thus avoiding lengthy delay due to litigation that may impair the public entity's ability to operate financially. (*Friedland v. City of Long Beach* (1998) 62 Cal.App.4th 835, 842-843, 73 Cal.Rptr.2d 427.) As noted, a validation proceeding differs from a traditional action challenging a governmental entity's decision because it is an in rem action, the effect of which is binding on the governmental entity and all other individuals. (*Embarcadero Mun. Improvement Dist. v. County of Santa Barbara, supra*, 88 Cal.App.4th at p. 789, 107 Cal.Rptr.2d 6.) Consequently, adequate notice as to the intended scope of a particular validation action by reasonably detailing the pertinent factual background and identifying the governmental action sought to be validated in the complaint and summons is paramount. (See Code Civ. Proc., § 861.1.) Moreover, the validation statutes require

consolidation of all challenges to a particular governmental action and the entry of a single judgment, as any challenges to the validity of the governmental action must be raised in the validation proceeding. (*N.T. Hill Inc. v. City of Fresno* (1999) 72 Cal.App.4th 977, 991, fn. 10, 85 Cal.Rptr.2d 562; Code Civ. Proc., §§ 865, 869, 870, subd. (a).) Finally, the governing statutory scheme does not specify the matters to which it applies; rather its procedures apply to any matter which under any other law is authorized to be resolved pursuant to it, including the validity of certain contracts of a governmental entity. (*Planning & Conservation League v. Department of Water Resources* (1998) 17 Cal.4th 264, 269, 70 Cal.Rptr.2d 635, 949 P.2d 488; Code Civ. Proc., § 860.)

\*6 The trial court correctly overruled the special demurrer for uncertainty. Granted, the validation action, the incorporated Ratification Acts, and the summons for publication failed to specifically identify not only the City and the Agency resolutions by date or title, but also each of the downtown redevelopment contracts by description, date or title, that were encompassed by the Ratification Acts and thus the validation action. However, they all placed in context that which the City and the Agency sought to do through the Ratification Acts and the validation action. Each sets forth a reasonably detailed factual background summarizing the parties, the passage of Proposition C, the MOU, the baseball park and redevelopment project, the execution of related contracts designed to implement the MOU, and the allegations regarding Stallings's misconduct. The complaint and published summons further explain that the Ratification Acts were passed so as to validate, ratify and approve as of the date of their initial making, the MOU (as an Agency contract) and every contract and agreement entered into implementing the MOU and related redevelopment plans to the extent they may be subject to challenge under sections 1090 and 1092. Finally, the validation complaint expressly prayed for the court to find that the Ratification Acts were valid and that the MOU and all related contracts and agreements

encompassed by the Ratification Acts are valid and binding upon the City and the Agency and not subject to further challenge under sections 1090 and 1092. Consistent with the statutory mandate for reasonable notice, the foregoing provided any interested party ample notice of the validation action and its scope. Moreover, the summons fully complied with the mandate in Code of Civil Procedure section 861.1 of providing "a detailed summary of the matter the public agency ... seeks to validate." Therefore, the special demurrer was not well taken.

Similarly, Furgatch's general demurrer on statute of limitations ground was properly overruled. He asserts that the validation action violated the 60-day time bar in Code of Civil Procedure section 860 at least as to the bond contracts that were approved on January 31, 2000. However, his argument rests upon a mistaken understanding of that which the City and the Agency sought to validate in their action. They did not seek to validate directly the bond contracts or any other downtown redevelopment agreement. Rather, they sought validation of the Ratification Acts (that ratified project related agreements), which were adopted the day before they filed the validation action. We emphasize the Ratification Acts were passed so as to validate, ratify and approve as of the date of their initial making, the MOU (as an Agency contract) and every contract and agreement entered into implementing the MOU and related redevelopment plans to the extent they may be subject to challenge due to Stallings's misconduct. Consequently, the validation action was timely.

\*7 Contrary to Furgatch's assertion, our conclusion here does not frustrate the governing 60-day statute of limitations, which is designed to expedite the validation process so as to promptly resolve all questions regarding the validity of the public entity's action (*Embarcadero Mun. Improvement Dist. v. County of Santa Barbara*, *supra*, 88 Cal.App.4th at p. 790, 107 Cal.Rptr.2d 6). The necessity for the City and the Agency action here arose well after the governmental entities entered the MOU and implementing agreements when

Stallings's misconduct came to light, thus casting doubt as to the validity of the agreements and jeopardizing the ballpark redevelopment project. Legal validation of the downtown redevelopment contracts had long since been barred by the governing 60-day statute of limitations. However, following her resignation from the city council, the City and the Agency adopted the Ratification Acts and brought the validation action so as to protect the underlying agreements from future conflict of interest challenges based upon Stallings's wrongful acts. Given the independent intervening circumstance of Stallings's misconduct, our application of the 60-day statute of limitations here as to the validation of the Ratification Acts is wholly consistent with the underlying purposes of the statutory scheme generally and the statute of limitations specifically. We reiterate that validation is sought here as to that which the City and the Agency attempted to do by their Ratification Acts, not directly as to the underlying MOU (as an Agency contract) and the implementing downtown redevelopment contracts.

*THE CITY AND THE AGENCY'S VALIDATION  
 COMPLAINT AS TO THE RATIFICATION ACTS  
 NECESSARILY INCLUDED CITY CHARTER  
 SECTION 94*

[3] The City and the Agency limited their validation action to simply addressing whether the Ratification Acts were valid and legally effective in rendering the MOU (as an Agency contract) and all other contracts and agreements to which they apply valid and binding upon them insofar as being duly adopted not subject to further challenge under sections 1090 and 1092 due to Stallings's misconduct. Furgatch challenges the propriety of such a "limited" validation action given it is a special in rem proceeding, while he and Teyssier assert that the City, the Agency and the court ignored the applicability of City Charter section 94 in addressing the merits of the validation action. As we shall explain, their challenges have merit as to process.

As we have already noted, the statutory validation

process is designed to provide a simple and uniform method for examining the validity of governmental action, that permits both speedy and *complete* resolution of the validity of the action in controversy. (*Embarcadero Mun. Improvement Dist. v. County of Santa Barbara*, *supra*, 88 Cal.App.4th at p. 789, 107 Cal.Rptr.2d 6.) Because the validation proceeding is an in rem action the effect of which is binding on the governmental entity and all other individuals, the statutory scheme details the mandatory requirements regarding notice as to the intended scope of a particular validation action, consolidation of all challenges to a particular governmental action and the entry of a single judgment, given that all challenges as to the validity of the action must be raised in that proceeding. (*N.T. Hill Inc. v. City of Fresno*, *supra*, 72 Cal.App.4th at p. 991, fn. 10, 85 Cal.Rptr.2d 562; *Committee for Responsible Planning v. City of Indian Wells* (1990) 225 Cal.App.3d 191, 196-197, 275 Cal.Rptr. 57; Code Civ. Proc., §§ 860, 861, 861.1, 862, 865, 869, 870, subd. (a).) Regardless whether by answer or cross-complaint to a public entity's summons, the statutory scheme construed as a whole enables all interested parties who may appear pursuant to notice published or otherwise to air and to resolve in one suit all their distinct concerns. (*Moorpark Unified School Dist. v. Superior Court* (1990) 223 Cal.App.3d 954, 957-960, 273 Cal.Rptr. 18.)

\*8 Within the context of the City and the Agency's motion for summary judgment, they assert that as plaintiffs they had the burden of making a prima facie showing they were entitled to judgment on their complaint. (*Aguilar v. Atlantic Richfield Co.* (2001) 25 Cal.4th 826, 850, 107 Cal.Rptr.2d 841, 24 P.3d 493.) They contend that even if City Charter section 94 presented a valid affirmative defense, they had no burden to make a prima facie showing against it. (*Aguilar*, *supra*, 25 Cal.4th at p. 853, 107 Cal.Rptr.2d 841, 24 P.3d 493.) They explain that the City Charter challenge to the underlying contracts was not a permissible attack on the theory of the complaint and summary judgment motion. The City and the Agency argue that the validation proceeding was limited, as

Furgatch and Teyssier were allowed to "appear and contest the legality or validity of the matter sought to be determined." (Code Civ. Proc., § 862.) They suggest that matter was not whether the downtown redevelopment contracts were potentially void under City Charter section 94, but whether the Ratification Acts protected those contracts from attack insofar as they are duly adopted not subject to further challenge under sections 1090 and 1092. We conclude, however, that the matter sought to be determined under the circumstances was whether the Ratification Acts were valid *generally* in protecting the downtown redevelopment contracts from legal challenge arising from Stallings's conflict of interest/misconduct. That resolution required evaluation within the context of not only sections 1090 and 1092, but also City Charter section 94. Stallings's conflict of interest/misconduct rendered legally vulnerable the underlying downtown redevelopment contracts under both, thus necessitating the enactment of the Ratification Acts-the governmental action sought to be validated.

The Ratification Acts contain general declarations of purpose to remove any doubt as to the validity of the underlying downtown redevelopment contracts caused by Stallings's conflict of interest/misconduct, without specifying the legal statutory or City Charter framework within which the public entities were working. Consistent with that intent, the City and the Agency utilized such general language in their attempt to remove *any* and *all* doubt as to the validity of the underlying redevelopment contracts. Guided by the underlying purposes and express language of the statutory validation scheme, we conclude the validity of the matter sought to be determined here is the validity of the underlying governmental action, to wit, the Ratification Acts. Thus, the City and the Agency cannot draft a validation complaint under the circumstances limited to determining the validity, or indeed the effectiveness, of the Ratification Acts within the context of only sections 1090 and 1092. To permit such pleading would promote piecemeal validation of governmental action, in complete defiance of the underlying legislative intent of

providing an expeditious process affording complete resolution of the validity of governmental action that is final and binding upon all. Simply stated, the validation process should not become a venue for technical pleading designed to limit challenges by interested parties to the action that the governmental entity purportedly seeks to validate.

\*9 Our conclusion that “the matter sought to be determined” here is the validity of the Ratification Acts generally in light of their express narrow purpose is entirely consistent with the general language of the Validation Law. It is devoid of any language that expressly or inferentially permits limited piecemeal validation of governmental action. Code of Civil Procedure section 860 simply requires a public entity to allege an action of a type subject to the validation process, plus a factual basis for venue. (*Meaney v. Sacramento Housing & Redevelopment Agency* (1993) 13 Cal.App.4th 566, 582, 16 Cal.Rptr.2d 589.) It does not provide for limited validation inquiry into the action the public entity seeks to be validated. Such would be inconsistent with the nature of an in rem proceeding. Code of Civil Procedure section 861.1 likewise first generally provides that the summons shall be directed to “all persons interested in the matter of [specifying the matter],” “but more specifically later in requiring a detailed summary of the matter the public agency seeks to validate. The matter is the public action, not the scope of the validation inquiry. Consequently, this latter notice requirement is intended to put the governmental action to be determined or validated within meaningful context.

Here, the summons provided the required detailed contextual summary but sought to limit the validity inquiry to sections 1090 and 1092. Nevertheless, it was directed “TO ALL PERSONS INTERESTED IN THE MATTER OF THE VALIDITY OF CONTRACTS AND AGREEMENTS REFERRED TO IN [THE RATIFICATION ACTS].” That is, the City and the Agency first specified the matter generally as the Ratification Acts. Given that the express narrow purpose for the Ratification Acts

was “to put to rest any doubt about the validity of the actions authorizing” the downtown redevelopment contracts caused by Stallings’s conflict of interest/misconduct generally, the City and the Agency’s limiting language regarding sections 1090 and 1092 in their validation complaint and summons does not preclude City Charter section 94 from being asserted as a valid affirmative defense to the validation of the Ratification Acts. The resolution of the validity of the Ratification Acts requires an evaluation of whether they were effective in protecting the downtown redevelopment contracts from any legal challenge arising from Stallings’s misconduct within the context of sections 1090 and 1092 as well as City Charter section 94. In fact, the City and the Agency acknowledge that “the exact purpose of the Ratification Acts was to free the Project from the arguendo-assumed effects of Stallings’s misconduct.”

*THE MOU AS A CITY CONTRACT WAS NOT  
 VULNERABLE TO CHALLENGE UNDER EITHER  
 THE GOVERNMENT CODE OR THE CITY  
 CHARTER*

[4] Teyssier contends the City, the Agency and the court erroneously excluded from the scope of the summary judgment the underlying legislative authorization necessary to empower the City and the Agency to enter into the downtown redevelopment contracts, namely the MOU as a City contract. He essentially argues that the validation judgment must be reversed because the City did not ratify the MOU as a city contract. Teyssier explains that the MOU constitutes the fundamental legislative authority for each of the actions re-adopted and ratified in the Ratification Acts. Because each action and contract flows from the MOU, Teyssier suggests that if the MOU is void *ab initio*, the actions and contracts ratified are deprived of their legislative foundation. In other words, the failure to ratify the MOU renders the Ratification Acts a nullity. We are unpersuaded.

\*10 Granted, Proposition C declares that its purpose and that of the MOU it authorizes are to

“constitute the legislative acts that establish policy for the City on these matters, and provide the ways and means for the implementation of that policy by such administrative and non-legislative acts as may be necessary and appropriate to carry out the purpose and intent of this ordinance....” Moreover, the electorate not only authorized, but also “directed,” the city manager to execute on behalf of the City the MOU that was incorporated within Proposition C. In addition, the electorate “authorized and directed” the City to enter into the agreements necessary to implement the ordinance and the MOU. The City and the Agency persuasively respond that even if every vote of the city council before the voters adopted Proposition C was void, the voters’ adoption of that measure expunged the City’s disability to act and rendered the MOU a valid obligation of the City. (See *Baker v. City of Palo Alto* (1961) 190 Cal.App.2d 744, 757, 12 Cal.Rptr. 425.) Teyssier offers no authority for the proposition a voter-approved contract is invalidated as a result of a conflict of interest of a public official who was one of many City council members involved in its negotiation and drafting before the matter was submitted to the electorate. He essentially asserts the City must readopt the MOU because Stallings committed fraud on the electorate by not disclosing the gifts she received from Moores. However, just as a popular vote cannot be set aside for alleged fraud of proponents of a measure (*Plaza Amusement Co. v. Carter* (1936) 11 Cal.App.2d 414, 416-418, 54 P.2d 67 [allegedly the false representation by the City that 25 percent of its voters signed initiative petition] ), by analogy the electorate’s approval of the MOU here should not be set aside because of Stallings’s conflict of interest in negotiating with her city council colleagues the precise terms of the MOU that the electorate later independently approved. To do so would require the impossible task of inquiring into the motives of each elector regarding how he or she voted. (*Ibid.*)

Teyssier challenges this conclusion, arguing this case does not involve fraud but the proper application of sections 1090 and 1092 and City Charter section 94. He asserts that nothing in the

cited sections suggests their application does not extend to a voter-approved contract, particularly where as here the conflict of interest existed at the time the terms of the contract were negotiated. After noting that City Charter section 94 broadly applies to “any contract with or for” the City, he queries regarding what possible public policy would be promoted by this court permitting a public official with a relevant conflict of interest to place a contract on the ballot, hide her conflict from the voters, and obtain voter approval? Teyssier miscasts the inquiry. Rather, under the circumstances presented here where Stallings was simply one member of a city council involved in the negotiation of the MOU, there was no allegation that relevant information was hidden from the electorate (the sample ballot & voter information pamphlet for the November 3, 1998 general election dedicated 42 pages to Prop. C, including the ordinance, the MOU and attachments, analyses, and arguments), and the decision by the city council to place the matter on the ballot was unanimous, what compelling public policy consideration would be meaningfully furthered by setting aside the electorate’s independent approval of the project and the precise terms of the MOU? We suggest that one does not exist.

#### *THE RATIFICATION ACTS ARE SUBJECT TO THE VALIDATION LAW*

\*11 [5] Furgatch contends that summary judgment should have been denied in the validation action because the City and the Agency failed to allege or establish the legal authorization for subjecting the Ratification Acts (and the contracts and agreements subsumed by them) to the validation process as required by Code of Civil Procedure section 860. Under the circumstances presented here, we conclude the Ratification Acts are subject to the Validation Law.

The primary statutory authorization subjecting contracts to the Validation Law appears in section 53511. It provides: “A local agency may bring an action to determine the validity of its bonds, warrants, contracts, obligations or evidences of

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indebtedness pursuant to Chapter 9 (commencing with Section 860) of Title 10 of Part 2 of the Code of Civil Procedure." The term "contract" has been reasonably interpreted to not refer to every municipal contract. (See *City of Ontario v. Superior Court* (1970) 2 Cal.3d 335, 340-344, 85 Cal.Rptr. 149, 466 P.2d 693; *Smith v. Mt. Diablo Unified School Dist.* (1976) 56 Cal.App.3d 412, 414, 128 Cal.Rptr. 572; *Phillips v. Seely* (1974) 43 Cal.App.3d 104, 111-112, 117 Cal.Rptr. 863.) The governing test that has evolved from the case law regarding what type of contract falls under the Validation Law is whether the lack of a prompt validating process would impair the public agency's ability to operate. (*Graydon v. Pasadena Redevelopment Agency* (1980) 104 Cal.App.3d 631, 644-645, 164 Cal.Rptr. 56; *Walters v. County of Plumas* (1976) 61 Cal.App.3d 460, 468, 132 Cal.Rptr. 174.) Especially within the context of the issuance of bonds, pending or imminent litigation drastically affects the marketability of public bonds, chilling potential third-party lenders and resulting in higher interest rates or even the total denial of credit, either of which might well impair a public entity's ability to pursue a public project. (*Graydon v. Pasadena Redevelopment Agency*, *supra*, 104 Cal.App.3d at p. 645, 164 Cal.Rptr. 56; *Walters v. County of Plumas*, *supra*, 61 Cal.App.3d at p. 468, 132 Cal.Rptr. 174.) Although the Validation Law does not apply to every contract, it is not limited to bonds or other financial instruments.

Guided by the foregoing, the Ratification Acts are subject to the Validation Law, given that they were designed to resolve any doubt as to the validity of the downtown redevelopment contracts that together implement an integrated redevelopment project valued at nearly \$500 million. Falling into essentially six categories, the implementing agreements are all directly linked to the necessary lease-revenue bond financing. They include: (1) the MOU (as an Agency contract), its amendments and implementation agreements that provide the necessary operational agreement for project development required for financing; (2) land acquisition and management agreements that place

the project land under the control of the MOU parties for development; (3) design and construction agreements that comprise the plan to complete the project; (4) settlement and planning agreements, constituting part of the design and construction process, effectuating changes in project plans; (5) a purchase and sale agreement with the port district for parking lots that fills a \$21 million gap in project financing; and (6) the bond contracts. In her declaration in support of the motion for summary judgment, deputy city manager Patricia T. Frazier explained that the aforementioned contracts, that enabled the City and the Agency to meet their obligations under the MOU and to complete the redevelopment project, were all integral to the entire project development finance process. The contracts relate to the project's financing by lease revenue bonds as approved by the City because the rating agencies, the underwriters, the sellers and the buyers of the bonds need to know that the project will be completed pursuant to a well-defined financial plan. If the underlying implementing agreements related to the project and the financing authorization are void, then the bonds will not be able to be sold and the project's financing will collapse. Consequently, under the circumstances presented here, the Ratification Acts are subject to the Validation Law.

#### SUMMARY JUDGMENT WAS PROPER

\*12 [6] Furgatch contends that summary judgment should have been denied because as a matter of law void contracts under sections 1090 and 1092 and City Charter section 94 cannot be legally resurrected by the Ratification Acts. We disagree.

"Generally, a governmental body may effectively ratify what it could previously have lawfully authorized. Ratification after the act is said to be as potent as authority before the act. Irregular and void acts may be ratified or confirmed at a subsequent meeting, provided it is a valid or legal meeting.... But ratification must be made with the same formalities required for the original exercise of power. Where the charter prescribes a method of doing the act, this mode must be observed in any



act of ratification. [¶] The above rules have been applied to numerous situations, including ... the ratification of municipal contracts, [the borrowing] of money ... and ... bond issues....” (4 McQuillin, Mun. Corp. § 13.47 (3rd ed.1992), pp. 878-879 (fns.omitted); accord, *Mott v. Horstmann* (1950) 36 Cal.2d 388, 391, 224 P.2d 11.)

In *Los Angeles Dredging Co. v. Long Beach* (1930) 210 Cal. 348, 359-360, 291 P. 839, the court recognized that any rule that void contracts cannot be ratified is limited to contracts which are beyond the powers of the public entity, or those in which some prescribed formality has irrevocably been disregarded. The court explained that such contracts cannot be ratified because ratification must be (1) based upon a previously existing power to make the particular contracts and (2) made in the manner prescribed for the making of such contract. In other words, where a public entity is without power to enter into a particular type of contract, it lacks the power to ratify it after performance. And, where the contract is one that is within the power of the public entity to make but requires a specific formality that was ignored, it is not subject to ratification where the mode of entering into it has irrevocably been disregarded. (*Id.* at p. 359, 291 P. 839.) However, void municipal contracts that are fully within the powers of the public entity may be effectively ratified if done so in the manner prescribed for the making of the contract. (*Id.* at pp. 359-360, 291 P. 839.) “Upon such ratification the contracts [become] binding upon the city as fully as though they had been previously entered into in the prescribed manner.”(*Id.* at p. 360, 291 P. 839.)

Here, the city council, acting on behalf of the City and as the Agency, was entitled to address the potential challenge that Stallings's misconduct rendered the downtown redevelopment contracts void under sections 1090 and 1092 and City Charter section 94 by adopting ordinances designed to reexecute and readopt the allegedly ineffective contracts previously consummated. The only condition precedent to such ratification was the removal of the public entity's disability, a condition that was met here when Stallings resigned and the

composition of the city council changed. (See *Baker v. City of Palo Alto*, *supra*, 190 Cal.App.2d at pp. 756-758, 12 Cal.Rptr. 425 .) We have reviewed the case authority proffered by Furgatch challenging our conclusion, but find it either inapposite or fatally distinguishable. We are convinced that this is the precise type of situation where ratification should be used by a public entity to correct potentially defective decisions, votes and actions.

\*13 [7] Teyssier contends the summary judgment on the validation action should be reversed because the City and the Agency failed to show that on March 6, 2001, no other city council member or official was financially interested in any of the downtown redevelopment contracts addressed by the Ratification Acts. Relying solely on his lawyer's declaration alleging a conflict of interest by other city council members that admittedly was unsupported by any specific factual basis, Furgatch likewise asserts that a triable issue of fact existed as to whether other city council members besides Stallings had such conflicts of interest. Their assertions are without merit. The City and the Agency bore no burden of establishing the acts of March 6, 2001 were regularly adopted, for such regularity is presumed. (Evid.Code, § 664.) Because this rebuttable presumption affects the burden of proof (Evid.Code, § 660), it relieves governmental entities from having to justify their conduct simply because it is challenged, shifting the burden to those who challenge official conduct to establish irregularity. (*Jackson v. City of Los Angeles* (1999) 69 Cal.App.4th 769, 781-782, 81 Cal.Rptr.2d 814.) Here, no issue of fact was raised regarding whether a member of the city council had a conflict of interest when it adopted the Ratification Acts given no meaningful evidence was submitted on the issue.

Furgatch also contends a triable issue of fact existed as to whether the City re-adopted all the resolutions subsumed by the Ratification Acts. In particular, he points to the sufficient assurances resolution adopted on March 31, 1999 (Resolution No. R-291450), listed in Resolution No. R-294638, because the city attorney explained to the city

council that it was not being asked to vote on the finding itself, of whether there were in fact appropriate sufficient assurances in a contractual sense as of March 31, 1999, but on the prior city council's legal right to vote as it did on that date. Within context, the city attorney simply explained the effect of their vote to ratify as necessary the particular resolution to reaffirm its validity. No triable issue of fact arises because the ratifying resolution expressly provides that the city council readopts and ratifies the sufficient assurances resolution "solely to the extent that it authorizes contracts and agreements, and takes such action as necessary to reaffirm the validity of the contracts and agreements authorized by it, commencing with its respective time of adoption, and to effectuate the continuing validity of the contracts and agreements authorized by it." Moreover, the matter is moot given that the ratifying resolution expressly provides that if any portion of the sufficient assurances resolution is determined to be void, the City waives any requirement to have received or acted upon the information set forth in that resolution by April 1, 1999. Further, the city attorney advised the city council that the mayor's new financing plan had replaced the plan the former city council was evaluating in March 1999.

*MISCELLANEOUS MERITLESS CONTENTIONS  
 REGARDING THE SUMMARY JUDGMENT  
 PROCESS*

\*14 Furgatch contends the trial court erred when it refused to permit discovery in advance of ruling on the motion for summary judgment. He complains about the timing of the summary judgment motion, which preceded the hearing on his special and general demurrers and the filing of his answer and affirmative defenses. He asserts that the premature calendaring required him to file his opposition papers by mid-June 2001, a time that preceded both the briefing schedule and the hearing on the pending demurrers. In other words, he contends that he was forced to defend the summary judgment motion based upon a complaint that at the time was under challenge and based upon affirmative defenses that had not yet been stated. No error

occurred. First, as to timing, the Legislature made a policy decision years ago to delete the language from Code of Civil Procedure section 437c that implicitly required an answer to be on file before a motion for summary judgment could be made. (*Sadlier v. Superior Court* (1986) 184 Cal.App.3d 1050, 1056, 229 Cal.Rptr. 374.) Second, Furgatch acknowledges he requested the court to continue the summary judgment motion hearing, but the court refused and invited him to make his objections pursuant to the "Code" (presumably, Code Civ. Proc., § 437c, subd. (h)). The court later denied his general request for a continuance to "develop facts extrinsic to the Complaint that would constitute affirmative defenses to validation of all the referenced actions and contracts ... [and to] conduct appropriate discovery." The court found he had failed to comply with the statutory requirements to specify what admissible evidence was available to justify opposition and why that evidence was not then available for submission. The record shows no affidavit detailing the necessary showing required under Code of Civil Procedure section 437c, subdivision (h) was filed.

Teyssier similarly argues the trial court erred in denying his request for continuance under Code of Civil Procedure section 437c, subdivision (h), because he had filed an adequate affidavit showing that facts may exist that other city council members had prohibited conflicts of interests similar to Stallings's as of March 6, 2001, when the council passed the Ratification Acts. Of relevance here, he specifically declared based on information and belief that city council member George Stevens "and/or his staff" had received 16 baseball tickets with food and drink worth approximately \$490 from the Padres in June 1998. Casting aside that the trial court sustained the City and the Agency's evidentiary objections to the declaration and assuming its propriety, the trial court did not err in denying his request. Granted, to mitigate the harshness of the summary judgment, Code of Civil Procedure section 437c virtually mandates a trial court to liberally grant a continuance upon a good-faith showing that one is needed to obtain facts essential to justify opposition to the motion. (*Bahl*

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*v. Bank of America* (2001) 89 Cal.App.4th 389, 395, 107 Cal.Rptr.2d 270.) However, the purpose of the required affidavit is to meaningfully inform the court of outstanding discovery that is necessary to resist the motion. It is not sufficient to merely indicate further discovery or investigation is contemplated. The party requesting that continuance must show facts essential to justify opposition may exist. (*Id.* at p. 397, 107 Cal.Rptr.2d 270; *Scott v. CIBA Vision Corp.* (1995) 38 Cal.App.4th 307, 325-326, 44 Cal.Rptr.2d 902; *Roth v. Rhodes* (1994) 25 Cal.App.4th 530, 548, 30 Cal.Rptr.2d 706.) The statutory provision further requires the party requesting the continuance to state reasons why the facts cannot be then presented. (Code Civ. Proc., § 437c, subd. (h).) Our review of the declaration persuades us it does not show facts essential to justify opposition existed. His allegations were immaterial to the summary judgment motion for failing to show any infirmity in the Ratification Acts. His specific allegation regarding city council member Stevens and/or his staff was framed under the Political Reform Act, not under section 1090 or City Charter section 94. The Political Reform Act conflict of interest provisions apply only to a vote that occurs within 12 months of the voting official's receipt of the improper gift. (§ 87103, subd. (e).) Moreover, his declaration failed to adequately state reasons why the facts could not be then presented. Consequently, because we conclude Teyssier has neither met the statutory conditions for a mandatory continuance nor shown the trial court abused its discretion in denying the request (see *Scott v. CIBA Vision Corp.*, *supra*, 38 Cal.App.4th at pp. 313-314, 44 Cal.Rptr.2d 902), the trial court did not err in denying his request for continuance.

\*15 Furgatch also asserts the order granting summary judgment was fatally deficient for failing to refer to the evidence proffered in support of the motion as required by Code of Civil Procedure section 437c, subdivision (g). Again, the contention is not well taken. Preliminarily, when summary judgment is the result of applying legal principles to undisputed facts, the trial court need not engage in an idle recitation of the undisputed factual basis.

(*Unisys Corp. v. Cal. Life & Health Ins. Guarantee Assn.* (1998) 63 Cal.App.4th 634, 640, 74 Cal.Rptr.2d 106.) Here, Furgatch and Teyssier admitted all the facts proffered by the City and Agency, and did not proffer any relevant, admissible conflicting evidence. Secondly, given that we review a summary judgment *de novo*, "even assuming such a deficiency, reversal would not be required. [Citations.] ' "It is the validity of the ruling which is reviewable and not the reasons therefor." ' [Citation.]" (*Ibid.*)

[8] Teyssier contends the trial court erred by severing Furgatch's cross-complaint, which was replete with common issues. He asserts the severance order violated his due process rights by "dividing to conquer" the opposition, that is the order effectively divided financial resources substantially reducing the possibility that these issues will be adequately litigated on behalf of the entire class represented by defendants. Although we agree the trial court erred in severing the cross-complaint, our review of the entire record persuades us that error was harmless.

The severance order caused the entry of two judgments. As an *in rem* proceeding, the statutory validation scheme requires the consolidation of all challenges to a particular governmental action and the entry of a single judgment disposing of all issues in the suit, the effect of which precludes any future challenge to the validity of that action. (*N.T. Hill Inc. v. City of Fresno*, *supra*, 72 Cal.App.4th at p. 991, fn. 10, 85 Cal.Rptr.2d 562; *Committee for Responsible Planning v. City of Indian Wells*, *supra*, 225 Cal.App.3d at pp. 195-198, 275 Cal.Rptr. 57; Code Civ. Proc., §§ 865, 869, 870, subd. (a).) Here, the June 29, 2001 judgment on the validation complaint, characterized as "PARTIAL JUDGMENT AS TO DEFENDANT FURGATCH," was interlocutory and technically nonappealable until disposition of Furgatch's cross-complaint, which occurred upon the second entry of judgment as to Furgatch on August 7, 2001. (*Committee for Responsible Planning v. City of Indian Wells*, *supra*, 225 Cal.App.3d at pp. 195, 198, 275 Cal.Rptr. 57.) Consistent with the one final

judgment rule, an appeal cannot be taken from a judgment that is not fully dispositive of all the causes of action between the parties even if those disposed of by the judgment have been severed or ordered to be tried separately, or may be characterized as separate and independent from those remaining. (*Morehart v. County of Santa Barbara* (1994) 7 Cal.4th 725, 743, 29 Cal.Rptr.2d 804, 872 P.2d 143.) However, here, upon the filing of the second "judgment," the entire validation matter had been judicially resolved, rendering the aggregate substantive effect of the two "judgments" to be one single final one. Accordingly, we treat them together as constituting one single final judgment subject to our appellate jurisdiction and the premature notices of appeal from the "first judgment" as having been filed at the earliest permissible time. (Cal. Rules of Court, rule 2(d).)

\*16 Moreover, given the expedited fashion this entire matter was litigated and brought to complete disposition, the nature of the issues presented in both proceedings resulting in the "separate" judgments, their consolidation for appellate purposes and the governing standard of review for the issues presented calls for us to exercise our independent judgment, we conclude Teyssier was not prejudiced by the trial court's erroneous severance order.

[9] Finally, Teyssier's contention that the injunctive relief granted violates his state and federal constitutional rights to petition government is deemed abandoned. Preliminarily, the injunctive relief enjoining all persons and specifically Teyssier and Furgatch from instituting any action or proceedings challenging the validity of the Ratification Acts was entirely consistent with Code of Civil Procedure section 870, subdivision (a) which provides "the judgment shall permanently enjoin the institution by any person of any action or proceeding raising any issue as to which the judgment is binding and conclusive." Secondly, Teyssier's discussion of this issue is not only conclusory, but also woefully deficient, relying on two general case citations without any meaningful and fruitful argument in support of his claim. After

the City and the Agency noted this deficiency in their respondents' brief, Teyssier ignored the matter in his reply brief. Accordingly, "[s]uch a presentation amounts to an abandonment of the issue. [Citations.]" (*People ex rel. 20th Century Ins. Co. v. Building Permit Consultants, Inc.* (2000) 86 Cal.App.4th 280, 284, 103 Cal.Rptr.2d 71.)

*THE TRIAL COURT CORRECTLY SUSTAINED  
 THE DEMURRER TO TEYSSIER'S AFFIRMATIVE  
 DEFENSES*

Teyssier challenges the trial court's sustaining the City's and the Agency's demurrer without leave to amend and striking the affirmative defenses alleged in his answer. These included: (1) Proposition C was placed on the ballot in violation of CEQA; (2) the City and the Agency cannot rely on Proposition C because the City violated Municipal Code section 128.0311 by failing to prepare an environmental impact report (EIR) before the November 1998 general election; (3) the City violated City Charter section 90.3, requiring a public vote to approve a "major public project," by not submitting the Ratification Acts to a vote at a municipal election; (4) the City violated City Charter section 225 when it adopted the Ratification Acts because it did not possess complete ownership information about all parties to the downtown redevelopment contracts; (5) the City violated the MOU by not putting the Ratification Acts to a vote of the electorate; and, (6) the City violated City Charter section 23 by failing to accept and process referendum petitions concerning Ordinance No. O-18747 on March 8, 2001. In sustaining the demurrer without leave to amend, the trial court questioned the relevance and the propriety of the asserted defenses to this particular validation action, scolded Teyssier for continuing to raise issues previously adjudicated in related manners and noted that Teyssier failed to indicate any reasonable amendment under the circumstances. The trial court ruled correctly.

\*17 [10][11] First, the affirmative defenses relating to CEQA and the failure to file an EIR before the November 1998 general election do not constitute defenses to the validation of the Ratification Acts

and the underlying contracts that expressly excluded the MOU as a City contract. Indeed, they essentially request affirmative relief invalidating the MOU as a City contract on grounds not germane to the allegations of the validation complaint. This Court rejected the first contention in *Mailhot v. Abdelhour* (July 23, 1999, D032123) [nonpub. opn.]. Second, the City Charter section 90.3 affirmative defense does not apply because the Ratification Acts did not ratify the MOU as a city contract and cannot be construed as the City adopting a "major public project" within them. The Ratification Acts ratified implementing agreements, not agreements by which the City adopted a "major public project." Third, the asserted City Charter section 225 defense that the City failed to comply with the mandatory disclosure of business interests provision as to all parties to the underlying implementing agreements fails to state an affirmative defense. As we explained in *Currie v. City of San Diego* (March 28, 2001, D035891) [nonpub. opn.], filed on March 28, 2001, to the extent that provision grants the city council discretion to decide whether future disclosures should or should not be required, the court is not in a position to dictate that such discretion should be exercised in any particular way. (See *Rodriguez v. Solis* (1991) 1 Cal.App.4th 495, 506, 2 Cal.Rptr.2d 50.) Moreover, that charter section does not appear to have been adopted to create a private right of action for disgruntled citizens to torpedo measures with which they disagree. In any event, Teyssier belatedly challenges the underlying agreements and not the Ratification Acts.

Regarding the allegation the City violated the MOU by not putting the Ratification Acts to a vote of the electorate, he essentially contends that ratification of the downtown redevelopment contracts in some fashion violated City's \$225,000,000 investment cap provided for in MOU sections XV and XXXVIII. Given that the bond ordinance was validated against this precise challenge in *Currie*, that validation judgment has res judicata and collateral estoppel effect on all interested parties, including Teyssier. (Code Civ. Proc., § 870; see *Starr v. City and County of San Francisco* (1977)

72 Cal.App.3d 164, 177-179, 140 Cal.Rptr. 73.) Finally, regarding the City's alleged failure to accept and process referendum petitions concerning Ordinance No. O-18747 on March 8, 2001, the trial court correctly struck the proffered defense because the ordinance was adopted on January 31, 2000, and Municipal Code section 27.1117 requires the unnamed proponent of such a referendum to submit the petitions to the city clerk within 30 days of that date. Additionally, the 2001 date was a typographical error for 2000, as Teyssier evidently intended to resurrect *Zoebis v. Abdelhour* (March 9, 2001, D035872) [nonpub. opn.] that unsuccessfully challenged the same ordinance on the same ground.

*SUMMARY JUDGMENT WAS CORRECTLY  
 ENTERED AGAINST FURGATCH'S CROSS-  
 COMPLAINT*

\*18 Furgatch contends the trial court erred in granting the City and the Agency's motion for summary judgment on his cross-complaint in the validation action. He challenges the trial court's determination the cross-complaint was time-barred under Code of Civil Procedure sections 863 and 869 and also argues that as a matter of law, unlawful, void contracts cannot be legally resurrected by the Ratification Acts. In its order granting the motion for summary judgment, the trial court correctly characterized Furgatch's cross-complaint as essentially an invalidation action of the MOU and later actions taken to implement it and Proposition C, to which Furgatch referred to as the "Validation Matters." Within his responsive pleading, he asserted these agreements were void under sections 1090 and 1092 and City Charter section 94 due to the taint of Stallings's conduct and relationship with Moores and the Padres, which he alleged gave rise to a personal financial interest in the agreements. In summary, we have already concluded that the validation complaint regarding the Ratification Acts necessarily included any City Charter section 94 challenge, void contracts under these circumstances can indeed be ratified and rendered valid, the Ratification Acts are subject to the Validation Law, and summary judgment on the

validation complaint as a matter of law was proper within the context of both the City Charter and the Government Code. Consequently, mindful that the Ratification Acts evince the general intent of the city council to remove any doubt as to the validity of the underlying downtown redevelopment contracts caused by Stallings's conflict of interest/misconduct without limiting the legal basis, summary judgment as a matter of law was correctly entered on Furgatch's cross-complaint.

#### THE SKANE APPEAL

##### *ALTHOUGH THE TRIAL COURT ERRED IN SUSTAINING THE CITY'S DEMURRER TO THE SECOND AMENDED COMPLAINT WITHOUT LEAVE TO AMEND ON THE GROUNDS STATED, THE RESULTING JUDGMENT OF DISMISSAL WAS NEVERTHELESS PROPERLY ENTERED ON OTHER GROUNDS*

Skane and Mailhot assert that they have essentially alleged in their second amended complaint that public officials like Stallings have conspired with Moores and the Padres, reaching an understanding that as City contracts and other transactions were negotiated, approved and performed to the Padres' financial advantage each of them could be certain that their respective requests, both present and future, for valuable gifts would be met subject only to the continuing implementation of those transactions between the City and the Padres. They accurately point out that the pivotal issue of these consolidated appeals is whether the alleged financial interests being reviewed constitute prohibited conflicts of interest in City contracts or in the performance of such contracts. In other words, does case law and public policy support the City's assertion these alleged financial arrangements are not interests in contracts prohibited by either section 1090 or City Charter section 94, or both? As we shall explain, we conclude the alleged financial arrangements constitute prohibited conflicts of interests under section 1090 and City Charter section 94. However, although we conclude the trial court erred in sustaining the demurrer without leave to amend on

the ground that neither the gifts nor the expectation of future gifts were predicated on contract and thus did not constitute an interest in the outcome giving rise to a prohibited financial interest, the demurrer was nevertheless correctly ruled upon as to these causes of action because the MOU as a City contract was not subject to challenge (at pp. 21-23, *ante*) and the remaining conflict of interest allegations within the complaint are moot upon our affirmance of the validity of the Ratification Acts (at pp. 11-22, 23-38, *ante*). Concluding the interim funding resolution did not violate the City Charter, we affirm the judgment.

\*19 Skane and Mailhot's second amended complaint alleges in detail the transactions that Stallings admitted in her plea bargain she had had with Moores between 1996 and 2000. It also alleges a pattern of similar gift giving involving other public officials. The intent in doing so was to establish the unusual and extensive nature of the transactions that occurred during a crucial time to the Padres regarding their negotiations with the City and the implementation of Proposition C and the MOU. Skane and Mailhot theorize that public corruption not only contaminated the implementation of the public or private joint business venture undertaking the ballpark project, but also has sullied the negotiations and city council approval of the terms of Proposition C and the MOU voiding both their implementation and approval by the electorate. More specifically, they allege that the gifts and favors were given for the express purpose of obtaining a material financial advantage over government with the intent of placing government officials under personal obligation to Moores and the Padres. They aver Moores and Stallings reached an oral understanding in 1996 that so long as she cast her votes and used her influence to further the financial interests of Moores and the Padres, she could indefinitely obtain gifts for herself and others designated by her. They characterize this quid pro quo arrangement as the "Gift By Command Conspiracy." By making these gifts, Moores created a financial interest on the part of Stallings and others to continue voting and implementing the

financial interest of the JMI defendants. Skane and Mailhot allege that Stallings provided Moores with highly confidential and valuable information in part from closed sessions of the city council, materially impacting the negotiation of the terms of the MOU. In fact, she cast the deciding vote on June 16, 1998, rejecting the effort of other city council members to increase the financial demands on the Padres. Moreover, during that summer, she cast her votes and exercised her influence so as to include in the final terms of the MOU all of the Padres' demands. They opine as a consequence of this activity, the Padres gained in the negotiation of the final terms of the MOU a financial advantage in excess of \$100 million. It is within this context that Skane and Mailhot contend the trial court erred in sustaining the City's demurrer without leave to amend to their first cause of action seeking a declaration that prohibited financial interests of city council members voided the contracts made by the City and the Agency between April 1996 and December 2000 relating to the MOU under sections 1090 and 1092.

*Stallings Acquired A Prohibited Financial Interest  
 Under Section 1090 As Alleged By Skane And  
 Mailhot*

Codifying the common-law prohibition of public officials having a financial interest in contracts they make in their official capacities (*BreakZone Billiards v. City of Torrance* (2000) 81 Cal.App.4th 1205, 1230, 97 Cal.Rptr.2d 467; *Terry v. Bender* (1956) 143 Cal.App.2d 198, 206, 300 P.2d 119), section 1090 pertinently provides: "Members of the Legislature, state, county, district, judicial district, and city officers or employees shall not be financially interested in any contract made by them in their official capacity, or by any body or board of which they are members." Section 1092 in turn provides that every contract made in violation of section 1090 "may be avoided at the instance of any party except the officer interested therein." A contract in which a public officer is interested that thus violates section 1090 is void, not merely voidable. (*Thomson v. Call* (1985) 38 Cal.3d 633, 646, fn. 15, 214 Cal.Rptr. 139, 699 P.2d 316.)

\*20 Conflict-of-interest statutes are predicated upon "[t]he truism that a person cannot serve two masters simultaneously." (*Id.* at p. 637, 214 Cal.Rptr. 139, 699 P.2d 316.)

"The duties of public office demand the absolute loyalty and undivided, uncompromised allegiance of the individual that holds the office. [Citations.] Yet it is recognized 'that an impairment of impartial judgment can occur in even the most well-meaning men when their personal economic interests are affected by the business they transact on behalf of the Government.' ' [Citations.] Consequently, our conflict-of-interest statutes are concerned with what might have happened rather than merely what actually happened. [Citation.] They are aimed at eliminating temptation, avoiding the appearance of impropriety, and assuring the government of the officer's undivided and uncompromised allegiance. [Citation.] Their objective 'is to remove or limit the possibility of any personal influence, either directly or indirectly which might bear on an official's decision....' [Citations.]" (*People v. Honig* (1996) 48 Cal.App.4th 289, 314, 55 Cal.Rptr.2d 555.)

Given these underlying purposes and objectives, the scope of the conflict-of-interest statutes is not limited to instances of actual fraud, dishonesty, unfairness or loss to the governmental entity, and criminal responsibility is evaluated without regard to whether the contract at issue is fair or oppressive. Indeed, such matters have been judicially declared as irrelevant under section 1090. (*People v. Honig, supra*, 48 Cal.App.4th at p. 314, 55 Cal.Rptr.2d 555.) Rather, the statutory provisions were designed to establish rules governing the conduct of governmental officials, unconcerned with the technical terms and rules applicable to the making of contracts. Accordingly, these statutory provisions are not to be accorded a narrow and technical interpretation that would limit their scope and defeat their underlying legislative purpose. (*Ibid.*; *Stigall v. City of Taft* (1962) 58 Cal.2d 565, 569-571, 25 Cal.Rptr. 441, 375 P.2d 289.)

The phrase "financially interested" in section 1090



has been so interpreted. The proscribed interest includes not only any direct interest (e.g. when an officer enters directly into a contract with the body of which he or she is a member), but also any indirect interest (e.g. when an officer is a shareholder of entity conducting business with the board upon which the officer serves, or sells his/her business to a son and takes a promissory note secured by a chattel mortgage on the business and the board upon which the officer serves awards contracts to the son's business). (*Thomson v. Call*, *supra*, 38 Cal.3d at p. 645, 214 Cal.Rptr. 139, 699 P.2d 316, and cases there cited.) In other words, "[t]he law does not require that a public officer acquire a transferable interest in the forbidden contract before he [she] may be amenable to the inhibition of the statute, nor does it require that the officer share directly in the profits to be realized from a contract in order to have a prohibited interest in it. [Citations.]" (*People v. Honig*, *supra*, 48 Cal.App.4th at p. 315, 55 Cal.Rptr.2d 555.) Rather, "[s]ection 1090 is 'concerned with any interest, other than perhaps a remote or minimal interest, which would prevent [public] officials from exercising absolute loyalty and undivided allegiance' to the public entity they serve. [Citation.]" (*Finnegan v. Schrader* (2001) 91 Cal.App.4th 572, 579, 110 Cal.Rptr.2d 552, quoting *Stignall v. City of Taft*, *supra*, 58 Cal.2d at p. 569, 25 Cal.Rptr. 441, 375 P.2d 289; see also *People v. Honig*, *supra*, 48 Cal.App.4th at p. 315, 55 Cal.Rptr.2d 555.)

\*21 Prohibited financial interests are not limited to express agreements for benefit and in fact need not be established by direct evidence. Instead, such forbidden interests extend to expectations of benefit arising from express and implied agreements inferred from the surrounding circumstances. (*Ibid.*; see *Thomson v. Call*, *supra*, 38 Cal.3d at p. 645, 214 Cal.Rptr. 139, 699 P.2d 316; *People v. Deysher* (1934) 2 Cal.2d 141, 149-150, 40 P.2d 259; *People v. Vallerga* (1977) 67 Cal.App.3d 847, 867, 136 Cal.Rptr. 429; *People v. Darby* (1952) 114 Cal.App.2d 412, 429-432, 250 P.2d 743.) Our independent research of the underlying legislative documents probative of the intent behind section

1090 produced nothing that would challenge the foregoing interpretation of the intended scope of that provision.

[12] In response to the City's assertion that Stallings's misconduct did not violate section 1090, Skane and Mailhot contend they have sufficiently alleged financial dealings between City officials and the Padres, especially Stallings, as chronicled in her plea bargain, that constitute prohibited financial interests in contract under section 1090. They reiterate that the crux of their allegations is that City officials expected present and future gratuities from the Padres in exchange for negotiating, adopting and implementing contracts favorable to their financial interests, understanding that those gratuities would be forthcoming *only if* the contracts with the City were in fact favorable to the Padres' financial interests. Although the parties characterize this issue as a matter of first impression, we conclude the firmly established law summarized above compels a holding that Stallings's misconduct violated section 1090. Indeed, given that the conflict-of-interests statutes must be liberally construed, it can be reasonably inferred from the surrounding circumstances that Stallings harbored an expectation of benefit arising from an implied agreement that as long as she furthered the Padres' financial interests they would in turn further hers.

The City's argument that Stallings's misconduct did not violate section 1090 is unpersuasive. Its assertion section 1090 need not be construed to apply to an extrinsic bribe in order to secure the deterrence and punishment of criminal law simply begs the question. The issue before us is whether Stallings's misconduct or that alleged of other public officers gave rise to prohibited financial interests in government contracts under section 1090—a statute concerned with any interest, neither remote nor de minimus in character, which would prevent a public official from exercising absolute loyalty and undivided allegiance to the best interests of the City. The objective of section 1090, "to remove or limit the *possibility* of any personal influence, either directly or indirectly which might

bear on an official's decision, as well as to void contracts which are actually obtained through fraud or dishonest conduct" (*Stigall v. City of Taft, supra*, 58 Cal.2d at p. 569, 25 Cal.Rptr. 441, 375 P.2d 289), cannot be ignored. The City's argument that the case law does not support applying section 1090 to the circumstances presented here is disingenuous. Such cannot be inferred from the absence of any decisional precedent completely in point applying section 1090 to facts identical to those confronting us here. Rather, to the extent this case presents a matter of first impression, it does so only within the context of applying firmly established law to a new set of facts.

\*22 The City's reliance on *Terry v. Bender, supra*, 143 Cal.App.2d at page 208, 300 P.2d 119, as supporting their narrow interpretation of section 1090 is misplaced. There, the contracting party's corrupt payments and services to the mayor were contingent on the perpetuation of the personal service contract in question, although extrinsic to it. The court expressly held that the interest revealed by the pleading was clearly a disqualifying one, because it was to the public officer's pecuniary advantage to insure the perpetuation of the contract. The court explained that the mayor's "interest" in the contract tainted it with illegality at least during the existence of his prohibited interest, which it characterized as a personal interest that might interfere with the unbiased discharge of his duty to the public or prevent the exercise of his absolute loyalty to the best interests of City. (*Id.* at p. 207, 300 P.2d 119.) The court concluded that at the time the mayor voted to approve the warrant to Bender, he had acquired such an interest in the latter's contract as restricted his free exercise of the discretion vested in him for the public good. He had "placed himself in a position of economic servitude to Bender, his continued free use of the property passing to him from Bender and his appropriation of the rents therefrom being dependent on Bender's retention of his contract with the city. [The mayor had] agreed to use his official position and influence in Bender's behalf in exchange for the monetary benefits flowing from Bender's largesse towards him."(*Ibid.*) Consequently, given the

factual similarities of the contracting parties's extrinsic largesse, its continuation dependent upon favorable action by the public entity and the public officer's use of his/her official position on behalf of the contracting party both here and in *Terry v. Bender*, the latter decision persuasively supports our conclusion that Stallings had acquired a prohibited financial interest in the contested contracts between the City and the Padres under section 1090 as alleged by Skane and Mailhot.

Similarly, the City's reliance on *BreakZone Billiards v. City of Torrance, supra*, 81 Cal.App.4th 1205, 97 Cal.Rptr.2d 467, for the proposition that extrinsic payments do not create a financial interest in a contract, is misplaced. There, plaintiff contended that campaign contributions from his lessor, who had an interest in disapproval of his permit application, triggered a section 1090 violation. The reviewing court disagreed, emphasizing the conflict of interest doctrine requires that the public officer have some interest in the outcome, whether direct or indirect. (*Id.* at p. 1230, 97 Cal.Rptr.2d 467.) The City contends that Skane and Mailhot never claimed Stallings had an interest in the outcome of a contract or even in her votes. Again, it proffers a myopic interpretation of the scope of section 1090 while misreading the precedent. The *BreakZone* court recognized that while an interest in the outcome need not be a present interest but may arise after the taking of the governmental action, the record was devoid of any factual allegations invoking the indirect interest rule. The court explained that it is not sufficient that a public officer desires to advocate the position of a campaign supporter. "[T]here must be some financial or pecuniary benefit to the governmental official which could sway his or her judgment."(*Id.* at p. 1231, 97 Cal.Rptr.2d 467.) Further, the court emphasized that the record did not contain any facts from which it could conclude that any of the recipients of campaign contributions would derive any personal benefit from a vote to overturn the determination of the planning commission or demonstrate that a vote against the application would benefit the contributor. (*Ibid.*) The court contrasted the facts of its case with those involving

a campaign contribution made in return for an express promise to exercise governmental authority in a particular way regarding a specific pending or imminent matter or a reward for an earlier governmental action, finding neither factual circumstance were suggested there. (*Id.* at p. 1233, 97 Cal.Rptr.2d 467.) Consequently, the *BreakZone* decision is not in conflict with our determination that the circumstances presented here constitute a prohibited financial interest in contract under section 1090.

*Stallings Also Acquired A Prohibited Financial Interest Under City Charter Section 94*

\*23 Although Skane and Mailhot did not challenge the validity of the contracts at issue under City Charter section 94 in their second amended complaint, they join Furgatch and Teyssier and do so on appeal. Characterizing City Charter section 94 as the first line of defense for citizens to defend against corrupt practices and conflicts of interest on the part of their elected municipal representatives, Skane and Mailhot assert that the charter language is broader and more inclusive than the language of its counterpart section 1090, rendering any contracts in violation of the former separately void.

City Charter section 94 pertinently provides that “[n]o officer, whether elected or appointed, of The City of San Diego shall be or become directly or indirectly interested in, or in the performance of, any contract with or for The City of San Diego,.... [¶] All contracts entered into in violation of this Section shall be void and should not be enforceable against said City....” Skane and Mailhot suggest the Charter provision significantly expands its effective scope by covering direct and indirect interests “in the performance of” any City contract. They emphasize that City Charter section 94 does not contain the limiting language of section 1090 to contracts “made by” public officials “in their official capacity, or by any body or board of which they are members,” but includes contracts for the City’s benefit over which the public official’s office “exercises legislative, administrative or quasi-judicial authority in the letting of or the

performance” of the contract. Moreover, they contend that the Charter language is not limited to “financial” interests, but covers interests in general that might exist on the part of an official in or in the performance of any contract with the City.

Relying on the City’s Code of Ethics (Council Policy CP-000-04, adopted effective Dec. 26, 1967), Skane and Mailhot suggest that the interests to be avoided under the Code of Ethics dovetail perfectly with City Charter section 94 and includes within the prohibited “direct” and “indirect” interests various categories of gifts and favors that would include those described in Stallings’s plea. In particular, they note that it is City policy that an elected official shall not have a financial or other personal interest, direct or indirect which is inconsistent with the proper discharge of his/her official duties or would tend to impair his/her independence or judgment or action in the performance of said duties. An elected official shall not use official information that is not available to the general public for his/her private gain or advantage or that of another. Additionally, no elected official shall receive or accept, directly or indirectly, any gift or favor from anyone doing business with the City under circumstances from which it can be reasonably inferred that such was intended to influence the public official in his/her duties or to reward him/her for official action.

\*24 In *City Council v. McKinley* (1978) 80 Cal.App.3d 204, 145 Cal.Rptr. 461, a panel of this court compared the language of section 1090 and City Charter section 94 and held that they were in complete harmony, “created to remove all indirect as well as direct influence of an interested officer in the discharge of his [her] duties.” (*Id.* at p. 213, 145 Cal.Rptr. 461; see also *City of Imperial Beach v. Bailey* (1980) 103 Cal.App.3d 191, 196-197, 162 Cal.Rptr. 663.) We agree with this general statement. As to specific application here however, we need not determine whether the latter is more expansive than the former and if so how much because Stallings’s conduct and relationship with the Padres gave rise to an indirect prohibited financial interest under either provision. Moreover,

it is firmly settled that under either the Government Code or the City Charter, the preliminary negotiations, discussions, reasoning, planning, and give and take to deciding whether to commit to a contract are deemed to be part of its making (letting). (*City of Imperial Beach v. Bailey*, *supra*, 103 Cal.App.3d at pp. 196-197, 162 Cal.Rptr. 663; *City Council v. McKinley*, *supra*, 80 Cal.App.3d at p. 212, 145 Cal.Rptr. 461.)

Thus, although we conclude the trial court erred in sustaining the demurrer without leave to amend on the ground that neither the gifts nor the expectation of future gifts were predicated on contract and thus did not constitute an interest in the outcome giving rise to a prohibited financial interest, the demurrer was nevertheless correctly ruled upon as to these causes of action because the MOU as a City contract was not subject to challenge (at pp. 21-23, *ante* ) and the remaining conflict of interest allegations within the complaint are moot upon our affirmance of the validity of the Ratification Acts (at pp. 11-22, 23-38, *ante* ).

*THE INTERIM FUNDING RESOLUTION DID  
 NOT VIOLATE THE CITY CHARTER*

Skane and Mailhot contend the trial court erred in granting summary judgment on their causes of action alleging that City Resolution No. R-293552, appropriating \$10,000,000 interim funding for the project (interim funding resolution), violated City Charter sections 73 and 84 because the city council allegedly adopted it without a recommendation from the city manager.

City Charter section 73 pertinently provides: "Upon written recommendation of the manager, the council may at any time transfer all or part of an unencumbered balance of an appropriation to a purpose or object for which the appropriation for the current year has proved insufficient..." Charter section 84 then relevantly provides: "No money shall be drawn from the treasury of the City, nor shall any obligation for the expenditure of money be incurred, except in pursuance of the Annual Appropriations Ordinance, and preliminary

appropriation ordinance, or of the annual appropriation changed as authorized by Section 73...."

The City budgetary process contemplates the city manager to annually prepare a budget pursuant to Charter section 69 that includes a general summary setting forth the aggregate budgetary figures in such manner as to reflect the balanced relations between the total proposed expenditures and the total anticipated income and other means of financing for the upcoming year. Utilizing the city manager's estimate as a basis, the city council pursuant to Charter section 71 adopts an "annual appropriations ordinance" as formed, arranged and itemized by the city auditor and comptroller and the city attorney. That ordinance essentially adopts the City's budget for the upcoming fiscal year, appropriating funds accordingly. It is subject to amendment throughout the year and, when amended to add a new appropriation, estimated revenue is also added to keep the budget balanced. Further, within context, an appropriation does not constitute an absolute authorization to expend funds, as other factors limit the authority to do so including funding availability, spending limits and rules regarding the source of revenue. Specific authorization to expend funds is generally given by the city council conditioned on the city auditor and comptroller certifying that the funds are available for that purpose in the city treasury. Moreover, the City's budget is balanced with regard to income and expenditures. An appropriation is thus not an expenditure. Appropriations, especially for capital projects, may overlap fiscal years but the funds may not be expended for that appropriation unless they are present in the city treasury in the fiscal year they are to be spent. Charter section 84, among other charter provisions, is designed to keep the annual budget balanced by requiring the city auditor and comptroller to certify, for any expenditure, that the money has been appropriated and that the funds exist in the city treasury for that purpose.

\*25 Here, although the city manager did recommend adopting the interim funding

resolution, Skane and Mailhot challenge his compliance with the Charter in that his request for city council action refers to \$3.8 million, which was certified as available to be spent, while the resolution adopted on June 27, 2000, and re-adopted July 24, 2000, covers both that amount and an additional \$6.2 million as to which there was no certification of funds being immediately available. However, by city manager action dated July 31, 2000, the city manager later approved the transfer of funds to complete the additionally authorized \$6.2 million and the city auditor and comptroller certified the availability of the funds.

[13] The trial court correctly granted summary judgment for the City because City Charter section 73 does not expressly limit the city council from taking the challenged action. A charter city has full control over its municipal affairs, subject only to the clear and explicit limitations and restrictions contained in its charter. That is, a charter operates not as a grant of power, but rather as an instrument of limitation, restricting the exercise of power over all municipal affairs which City is assumed to possess. Any enumeration of powers does not constitute an exclusion or limitation. (*City of Grass Valley v. Walkinshaw* (1949) 34 Cal.2d 595, 598-599, 212 P.2d 894; *City of Santa Monica v. Grubb* (1966) 245 Cal.App.2d 718, 724, 54 Cal.Rptr. 210.) "A city charter is construed to permit the exercise of all powers not expressly limited by the charter or by superior state or federal law." [Citation.] Restrictions on a charter city's powers may not be implied. [Citation.] (*Taylor v. Crane* (1979) 24 Cal.3d 442, 450-451, 155 Cal.Rptr. 695, 595 P.2d 129.) Although the City Charter contemplates guiding and accountability roles for the city manager, the city auditor and comptroller and the city attorney in the budget adoption process, it is the city council that adopts the annual appropriations ordinance" and may amend it at any time during the fiscal year like any other ordinance. Consequently, it would be entirely inconsistent with that authority to construe Charter section 73 as impliedly limiting the city council's power to transfer appropriations except upon a written recommendation of the city manager. Once

the city council authorizes the transfer of an appropriation, the transfer cannot be completed unless the transferred funds are unencumbered and unavailable.

In any event, any procedural error in the transfer of appropriations was cured by the July 31, 2000 approval by the city manager of the transfer of funds from certain accounts to complete the additional \$6.2 million authorized by the interim funding resolution and certification by the city auditor and comptroller of the availability of the funds. Because the funds were unencumbered and available for expenditure, the City budget remained balanced. Additionally, because Skane and Mailhot based their Charter section 84 violation upon a finding that Charter section 73 was violated, absent that predicate finding, that theory is also without merit.

\*26 Finally, although the parties do not address the issue of mootness, these legal challenges to the interim funding resolution appear moot upon the issuance of the lease revenue bonds this year. The resolution expressly states that pursuant to the MOU the interim funding is provided "until such time as permanent financing [can] be obtained." Presumably, the interim funding was repaid after the sale of the bonds.

#### DISPOSITION

The judgments are affirmed. Respondents are entitled to costs on appeal.

WE CONCUR: BENKE, Acting P.J., and NARES, J.  
 Cal.App. 4 Dist., 2002.  
 City of San Diego v. Furgatch  
 Not Reported in Cal.Rptr.2d, 2002 WL 1575109  
 (Cal.App. 4 Dist.)

END OF DOCUMENT



# EXHIBIT 5

## City of San Diego City Charter

### **Section 94: Contracts**

In the construction, reconstruction or repair of public buildings, streets, utilities and other public works, when the expenditure therefor shall exceed the sum established by ordinance of the City Council, the same shall be done by written contract, except as otherwise provided in this Charter, and the Council, on the recommendation of the Manager or the head of the Department in charge if not under the Manager's jurisdiction, shall let the same to the lowest responsible and reliable bidder, not less than ten days after advertising for one day in the official newspaper of the City for sealed proposals for the work contemplated. If the cost of said public contract work is of a lesser amount than the figure established by ordinance of the City Council, the Manager may let said contract without advertising for bids, but not until the Purchasing Agent of the City shall have secured competitive prices from contractors interested, which shall be taken under consideration before said contract is let. The Council may, however, establish by ordinance an amount below which the Manager may order the performance of any construction, reconstruction or repair work by appropriate City forces without approval by Council. When such Council approval is required, the Manager's recommendation shall indicate justification for the use of City forces and shall indicate whether the work can be done by City forces more economically than if let by contract.

In case of a great public calamity, such as extraordinary fire, flood, storm, epidemic or other disaster the Council may, by resolution passed by a vote of two-thirds of the members elected to the Council, determine and declare that the public interest or necessity demands the immediate expenditure of public money to safeguard life, health or property, and thereupon they may proceed, without advertising for bids or receiving the same, to expend, or enter into a contract involving the expenditure of any sum required in such emergency, on hand in the City treasury and available for such purpose. All contracts before execution shall be approved as to form and legality by the City Attorney.

Each bidder shall furnish with his bid such security or deposit insuring the execution of the contract by him as shall be specified by the Council or as provided by general law.

For contracts exceeding \$100,000.00, the Council shall require each contractor to insure the faithful performance of his contract by delivering to the City a surety bond in an amount specified by the Council, executed by a surety company authorized to do business in the State of California; provided, however, that in all contracts the Council shall require the retention of sufficient payments, under the contract to insure the protection of the City against labor or material liens.

The Council, on the recommendation of the Manager, or the Head of the Department not under



## City of San Diego City Charter

the jurisdiction of the Manager, may reject any and all bids and readvertise for bids. The Council may provide that no contract shall be awarded to any person, firm or corporation if prison or alien labor is to be employed in performing such contract, or if the wage schedule for employees engaged in performing such contract is based on more than eight hours of labor per day. Any contract may be let for a gross price or on a unit basis and may provide for liquidated damages to the City for every day the contract is uncompleted beyond a specified date. It shall be competent in awarding any contract to compare bids on the basis of time completion, provided that when any award has been made in consideration, in whole or in part, of the relative time estimates of bidders for the completion of the work, the performance in accordance with such time limits shall be secured by a surety bond as hereinabove provided with adequate sureties and penalties, and provided further, that for any contract awarded solely or partially on a specified time for completion the Council shall not extend such time limits unless such extension be recommended by the Manager and the Head of the Department concerned.

No officer, whether elected or appointed, of The City of San Diego shall be or become directly or indirectly interested in, or in the performance of, any contract with or for The City of San Diego, or in the purchase or lease of any property, real or personal, belonging to or taken by said City or which shall be sold for taxes or assessments or by virtue of legal process or suit of said City. Any person wilfully violating this section of the Charter shall be guilty of a misdemeanor and shall immediately forfeit his office and be thereafter forever barred and disqualified from holding any elective or appointive office in the service of the City. No officer, whether elected or appointed, shall be construed to have an interest within the meaning of this section unless the contract, purchase, lease, or sale shall be with or for the benefit of the office, board, department, bureau or division with which said officer is directly connected in the performance of his duties and in which he or the office, board, department, bureau or division he represents exercises legislative, administrative or quasi-judicial authority in the letting of or performance under said contract, purchase, lease or sale.

All contracts entered into in violation of this Section shall be void and shall not be enforceable against said City; provided, however, that officers of this municipality may own stock in public utility service corporations and the City permitted to contract for public utility service when the rates for such service are fixed by law or by virtue of the Public Utilities Commission of the State of California; and provided further, that no officer shall be prohibited from purchasing the services of any utility whether publicly or privately owned, whether or not the rates are fixed by law or by the Public Utilities Commission of the State of California; and provided further, that in designating any bank as a depository for the funds of said City, any officer interested as a stockholder or otherwise in such bank shall not be deemed to have an interest in such City contract within the meaning of this section, and in each of the cases enumerated herein such contracts shall be valid and enforceable obligations against the municipality.

City of San Diego City Charter

*(Amendment voted 03-13-1945; effective 04-09-1945.)*

*(Amendment voted 03-11-1947; effective 03-24-1947.)*

*(Amendment voted 03-10-1953; effective 04-20-1953.)*

*(Amendment voted 09-17-1963; effective 02-11-1964.)*

*(Amendment voted 11-04-1975; effective 12-01-1975.)*

*(Amendment voted 11-02-1976; effective 01-12-1977.)*

*(Amendment voted 09-20-1977; effective 11-18-1977.)*

*(Amendment voted 11-03-1998; effective 12-04-1998.)*

# EXHIBIT 6

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# M E M O R A N D U M

August 18, 2004

*Privileged and Confidential*  
*Attorney-Client Privileged*  
*Attorney Work Product*  
*Do Not Disclose*

TO: Investigation File  
Richard C. Sauer

FROM: Paul Maco

RE: *City of San Diego*; Interview of Gerald E. Boltz and Matthew D. Anhut

This memorandum summarizes the telephone interview with Gerald E. Boltz and Matthew D. Anhut of Bryan Cave LLP. This memorandum does not contain a verbatim or a near-verbatim transcription of this interview, but rather is a general summary of my thoughts and impressions regarding our discussion. It is organized to summarize issues thematically and does not necessarily reproduce the order in which the interview actually occurred. There was no stenographer present during this interview, and given the nature of summarizing this type of discussion after the fact, this memorandum does not attempt to describe every statement or exchange and it is possible that there are errors in this account. It also assumes familiarity with the facts of this case, and does not provide context or explanation of every factual reference. Nor does it address issues of credibility or attempt to reconcile any differences between this interview and the accounts of other individuals.

This memorandum is subject to the attorney client and the attorney work product privileges, as it was prepared in connection with our providing legal advice to the City of San Diego (the "City") in connection with a potential SEC investigation regarding some of the matters discussed in this memorandum.

At the outset of the interview, Messrs. Boltz and Anhut were advised that we represented the City in connection with both an internal investigation regarding various matters related to errors in the City's financial statements and bond disclosures as well as an SEC and U.S. Attorney investigation touching on those same matters, that we represent the City, and that the City had waived its attorney-client privilege for matters between January 1996 and February 2000.

The subject of this brief telephone interview was the 5-page letter of October 29, 2001 from Messrs. Boltz and Anhut to Leslie J. Girard, Esq. Assistant City Attorney, captioned

"Review of Disclosure Documents as to Lease Revenue Bonds 2001." (A copy of the letter is attached). Bryan Cave had been retained to provide advice relating to applicable federal securities laws to the City Council and the Board of Commissioners of the Public Facility Financing Authority of the City of San Diego in anticipation of the offering of the Lease Revenue Bonds 2001 for the new ballpark. As stated in its opening sentence, the letter "provides an overview of the applicable federal securities laws" and "a framework against which" the City Council and Board must review and evaluate the preliminary official statement and official statement.

Messrs. Boltz and Anhut said that the contents of the letter were also delivered to a closed session of the City Council as a "warning to them" of the requirements of federal securities laws and that the members were "cautioned greatly" as to these requirements. In the presentation, which followed the course of the letter, Mr. Boltz took the lead. Paul Webber and Les Girard were present. City Attorney Casey Gwinn may have been present. The context of the presentation was the heightened sensitivities following the allegations involving Councilmember Stallings; however, as in the letter itself, the need to take the steps identified was not explained as unique to the situation, but standard for municipal securities offerings.



# EXHIBIT 7

**BLUE RIBBON COMMITTEE REPORT  
ON  
CITY OF SAN DIEGO FINANCES**



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FEBRUARY 2002



**BLUE RIBBON COMMITTEE REPORT  
ON  
CITY OF SAN DIEGO FINANCES  
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**Attachments**

1. City of San Diego Achievements
2. Moody's California Cities Ratings
3. Moody's The Nation's Cities Ratings
4. Long Term Debt Analysis
5. Debt Service Analysis
6. General Fund Revenue Per Capita
7. General Fund Expenditures Per Capita

# EXECUTIVE SUMMARY

## BACKGROUND

In Mayor Dick Murphy's January 8, 2001 State of the City Address entitled "A Vision for San Diego in the Year 2020: A City Worthy of our Affection", he outlined ten goals for the City to focus on over the next four years. A concern raised by the Mayor was whether the City could afford to do the ten goals. As a result, Mayor Murphy announced he would convene a Blue Ribbon Committee on City Finances to perform an independent evaluation on the City's current fiscal health and make any appropriate recommendations. Furthermore, the Mayor stated that he would ask the City's independent Auditor and Comptroller Ed Ryan to provide staff support to the Committee. On April 27, 2001, the Mayor announced the following nine appointments to the Blue Ribbon Committee.

### Members of Blue Ribbon Committee on City Finances

- **Joe Craver-Chair**  
President and Chief Executive Officer  
Galaxie Management, Inc.
- **April Boling-Vice Chair**  
Certified Public Accountant
- **Mary Ball**  
President, San Diego County Taxpayers Association
- **William McCurine, Jr.**  
Attorney, Partner  
Solomon, Ward, Seidenwurm & Smith, LLP
- **Andrew Poat**  
Former Chief Deputy Director, CALTRANS
- **April Riel**  
Certified Public Accountant, Certified Fraud Examiner, MPA
- **Victor Vilaplana**  
Attorney, Seltzer Caplan McMahon Vitek
- **Richard Vortmann**  
President, National Steel and Shipbuilding Company (NASSCO)
- **Linc Ward**  
Chair, Zero-Based Management Review (ZBMR) of the Select Committee

Staff support to the Blue Ribbon Committee included Ed Ryan, City Auditor and Comptroller, Terri Aja Webster, Assistant City Auditor and Comptroller, and Marian Thompson, Executive Secretary.

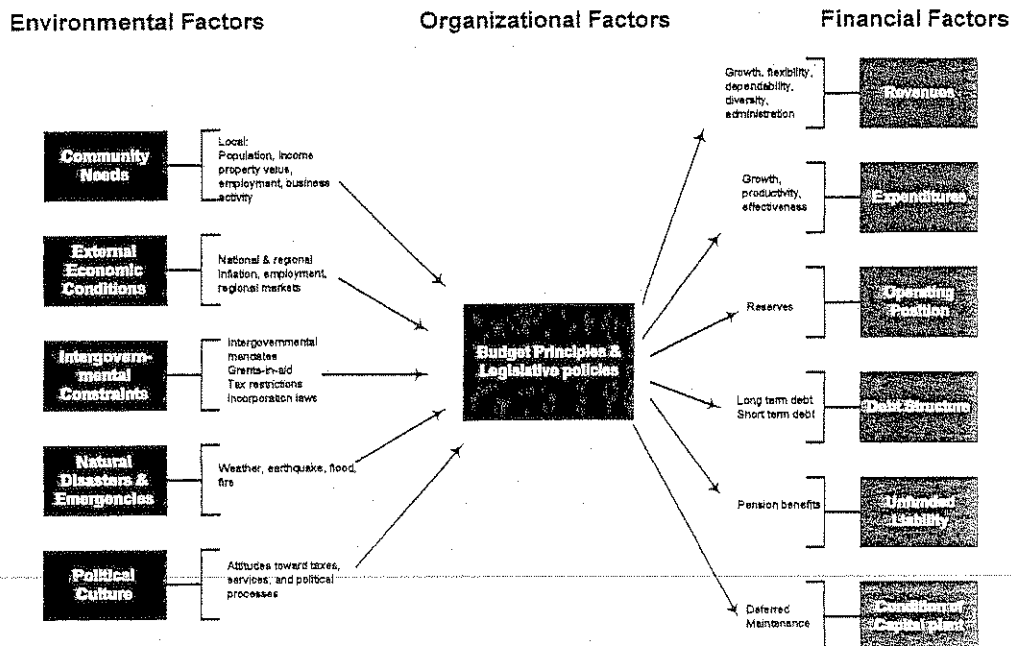
## OBJECTIVES

The objectives of the Blue Ribbon Committee on City Finances were as follows:

- *Perform an independent evaluation of the fiscal health of the City of San Diego,*
- *Review the budgeting principles of the City of San Diego, and*
- *Report findings and recommendations to Mayor Dick Murphy.*

The term “fiscal health” refers to the City’s ability to maintain existing service levels, withstand local and regional economic disruptions, and meet the demands of natural growth, decline, and change. In evaluating the City’s fiscal health, the Committee began by defining and evaluating a variety of financial and economic indicators and obtaining an understanding of the fiscal process. Requests were made to City staff to provide specific financial information, some of which are included in the attachments to this report. In addition, members of the Committee met with the City Manager who provided an overview of the annual budget process and the financial policies and procedures.

During this stage the Committee identified many indicators, which directly or indirectly affect the fiscal health of the City. These indicators were either environmental, organizational, or financial. Environmental factors such as population, unemployment, recession, and natural disasters are all non-controllable factors, which externally influence the City by creating demands and providing resources. This has a direct effect on organizational factors such as management practices and legislative policies. How well the City follows and addresses its budgeting principles relates directly to how well the City is responding to environmental factors. Finally, the financial factors reflect the condition of the City’s finances, which is the primary focus of our report. Below is an illustration of the factors affecting the fiscal health of the City:



As indicated, the primary focus of our review was to examine the financial factors. In doing so, the Committee selected six key fiscal areas to examine. In addition, the Committee reviewed the City's Budget Principles for compliance and adequacy. Below are the major areas addressed in this report:

- I. General Reserves and Insurance**
- II. Long Term Debt**
- III. Retirement Benefits and Unfunded Pension Liabilities**
- IV. General Deferred Maintenance and Unfunded Procurement**
- V. Water, Wastewater, Storm Water and Multiple Species Conservation Program**
- VI. Revenues and Expenditures**
- VII. Principles of Budgeting and Finance**

The Committee's analysis of the major areas involved interviews with City staff, reliance on financial information provided by City staff, review of the City's Fiscal Year 2002 budget, credit research reports from the independent rating agencies of Moody's and Standard and Poor's as well as comparative data from other large cities nationwide, and other financial information obtained. The City's financial statements are audited annually by an independent Certified Public Accounting Firm, Calderon, Jaham and Osborn. The City has received an unqualified (clean) audit opinion during the last ten years.

## FINDINGS AND RECOMMENDATIONS

The Committee found that in general the City of San Diego is fiscally sound. As shown in Attachment 1, the City has been recognized Statewide and Nationally for its achievements. However, the Committee identified several areas of concern and if not adequately dealt with, they could have a significant effect on the fiscal health of the City in future years. Below are the Committee's findings and recommendations in each of the major areas:

### I. General Reserves and Insurance

The Committee found that as of June 30, 2001, the City's General Reserves were \$30.5 million or approximately 4% of the total General Fund Revenues. This represents a substantial increase in reserves over the last 5 years. While reserves may never be sufficient to cover such one-time occurrences as large judgments or physical catastrophes, they should be sufficient to cover unplanned circumstances such as short-term economic downturns. The Committee was informed that the City maintains adequate insurance: worker's compensation, certain group health benefits and long-term disability, earthquake, general liability, and automobile liability insurance.

*Recommendation 1: Evaluate and determine what an adequate reserve level is for the City. At this time, the Committee recommends increasing the reserves to be between 7 to 10% of General Fund Revenues.*

### II. Long Term Debt

The Committee found that historically and currently, the City's total debt outstanding as well as total debt compared to all tax property valuations have been well below the median as compared to other major cities. The City's debt service has remained constant as compared to expenditures and revenues and is expected to increase only minimally with the addition of the proposed Ballpark, Fire Stations, and Library System bond issuances. The outside Rating Agency firms of Moody's, Standard and Poor's and Fitch evaluate the City's fiscal health in great detail and have consistently given the City high ratings which reflects a variety of very strong general credit characteristics such as the ability to repay long term debt, a diversified economy, moderate debt burden and strong financial management. See Attachments 2 and 3.

The Committee has no recommendations in this area and applauds City Management for its judicious use of debt.

### III. Retirement Benefits and Unfunded Pension Liabilities

The Committee is very concerned that the City is not paying out of its current year's budget the full cost being incurred by its current workforce for their future pension and retiree health benefits. The City is not paying approximately \$6-8 million a year for future pension benefits. As a result, a portion of the cost of today's City workforce will be paid by future year's taxpayers. Further, this non-discretionary item in the budget has been growing steadily and will continue to grow in the future.

*Recommendation 2: Change the City's funding strategy to one that results in the City fully funding its future obligations earned today which includes the pension benefits as well as health benefits.*

*Recommendation 3: Obtain a current and comprehensive analysis of projected pension expenses and revenue sources, which includes the current present value of retiree health benefits to determine the impact on future City finances.*

### IV. General Deferred Maintenance and Unfunded Procurement

The Committee estimates the City's unfunded deferred maintenance to be in excess of \$300 million in the areas of Streets, Alleys, Sidewalks, Street Light and Traffic Signals, Bridges, Buildings and Structures, Fleet, and Coastal Infrastructure and Facilities. Information provided to the Committee was preliminary or inconsistent with other reports obtained by the Committee. As a result, the Committee was unable to accurately quantify the backlog of unfunded deferred maintenance. The Committee believes, however, that the current level of funding is not reducing the backlog and is, instead, contributing to its increase.

The Committee was advised that the City has approximately \$170 million in Information Technology needs which is mainly unfunded procurement. These Information Technology needs result from a combination of technology improvement and early anticipation of future needs over the next 2-5 years.

*Recommendation 4: The City Manager should establish a process so that all deferred maintenance and unfunded procurement information is developed, aggregated, consistent, complete, non-duplicative, rated for priority, and is available on call for budgetary decisions.*

*Recommendation 5: The City Manager should prepare and present a public report during the annual budget hearings identifying the cumulative deferred maintenance backlog and unfunded procurement needs which includes asset descriptions, dollar requirements, and categorized by level of need with funding sources.*

*Recommendation 6: The City's policy with respect to funding deferred maintenance and Information Technology procurement should be revised to increase expenditures in these crucial areas. While the Committee notes some improvement in addressing deferred maintenance needs in some specific areas, other areas continue to deteriorate.*

## **V. Water, Wastewater, Storm Water, and Multiple Species Conservation Program**

The Committee found four major fiscal areas of future need. The four areas are water, wastewater, storm water, and multiple species conservation program. Findings in these areas are discussed below.

### **a. Water**

Overall, the Committee found the main areas of concern to be water storage, price and infrastructure needs. Action plans and financing plans are in place to address these concerns. These plans include a combination of bond issues and rate increases. An annual 6% rate increase is projected for a five-year period beginning in 2002. The Committee believes, if the City follows through with these plans and constantly monitors compliance with mandatory requirements, the City's fiscal health will not be impacted.

### **b. Wastewater**

The City has a viable plan for its Wastewater System. The plan will adequately cope with the expected growth in population, while steadily reducing the number of spills. However, it must be noted that the plan necessitates a 7.5% rate increase every year for four years. Additionally, the plan assumes continued "rollover" extensions of the 5-year waivers from the EPA on the treatment process.

Assuming the City maintains the waiver status, stays on track for an expanded replacement program and achieves the support of the public for future rate increase and bonds issues, the City's fiscal health will not be impacted.

### **c. Storm Water**

The Committee recognizes that the new Storm Water mandate presents a new concern to the fiscal health of the City. The City is in the process of working with public agencies to clarify the City's future costs and explore funding alternatives. In addition the City has an estimated \$143 million in general deferred maintenance for storm drains that needs to be addressed.

### **d. Multiple Species Conservation Program (MSCP)**

The Committee recognizes that the amount of MSCP future cost to the City is uncertain. Therefore, it is difficult to make a conclusion other than it appears that there could be a continued upward pressure of million of dollars per year on City finances. A strong effort to secure grants for this purpose is needed to minimize the cost to the City.



## **VI. Revenues and Expenditures**

The Committee found that between 1997 to 2001 total general fund revenues have increased by 38% from \$514 million to \$710 million, and is budgeted for Fiscal Year 2002 to be \$710 million, adjusted to a financial reporting basis. Revenues per capita have been increasing over the years but continue to be lower than other large cities. In regards to expenditures, the Committee found that between the Fiscal Years 1997 and 2001 total General Fund expenses increased 34% from \$521 million to \$700 million, averaging 7.7% growth per year. Budgeted increases through the Fiscal Year 2002 will bring expenses to \$745 million. The 5-year increase per annum averages 7.4%. Expenses per capita are lower than other large cities in the State and Nation.

In order to maintain the City's current service levels and address the various issues raised in this report, the City must pursue across-the-board efficiency efforts, as well as increase its current revenue base, and seek alternate revenue sources.

*Recommendation 7: Expand the current revenue sources and seek additional sources of revenue.*

*Recommendation 8: Seek ways to reduce expenditures either through improved operational efficiencies or elimination of specific services in deference to higher priority needs.*

## **VII. Principles of Budgeting and Finance**

The Committee found five of the six present City budget principles to be sound and recommends changing the remaining principle. Also, the Committee recommends the City follow two additional principles. Findings are discussed below.

### **a. Present Budget Principles**

#### **1. Ongoing Expenditures Should Be Supported By Ongoing Revenues**

The Committee strongly supports this principle, and urges its more constant adherence.

#### **2. The General Fund Should Maintain A 3% Reserve Of General Fund Revenue**

As discussed in Section I, the Committee recommends this principle be changed to reflect a requirement of 7-10% of General Fund revenue in total General Reserves (the current principle reflects only the General Fund portion of the General Reserves).

#### **3. Capital Projects Should Identify All Future Cost Considerations And Financial Impacts**

The Committee supports this principle, and finds that the current 12 year capital budget does generally identify some, but not all, ongoing costs.

**4. Include Direct And Indirect Costs For Each Enterprise Fund**

The Committee supports continued adherence to this principle and recommends the Mayor and Council direct the City Manager to review and formulate recommendations on the Right of Way fee as they relate to direct or indirect costs for the Water and Sewer Funds.

**5. Activities Supported By User Fees Should Be Fully Cost Recoverable**

The Committee recommends the City continue to respect the broad intent of this principle, particularly for the Enterprise Funds, but might want to consider amending the policy as it relates to the General Fund if current practice and public policy warrants it.

**6. Discretionary General Fund Revenues Should Not Be Earmarked**

This principle is not being followed in the case of the Library Ordinance whereby a percent of General Fund appropriations are to be earmarked for Libraries regardless of other competing needs such as deferred maintenance. The Committee supports adequate funding for libraries but recommends following this budget principle and maximizing the City's revenue flexibility.

**b. Proposed Principles**

*Recommendation 9: The City should follow its existing six budget principles and add two additional budget principles:*

*Proposed Principle #7: Budget development should be guided by a long term, or strategic budget plan proposed by the Manager and adopted by the Council.*

*Proposed Principle #8: Once adopted, annual budgets should be amended only when urgency requires, and then by identifying specific funding sources for these new priorities.*

**Follow-up Issues**

To ensure that the City prepares a long-range financial plan to adequately address the issues contained in this report in a timely manner, the Committee recommends that the City submit a report to the Blue Ribbon Committee which addresses the City's progress on each of the recommendations. The Committee will reconvene to review the report and the progress the City has made in regards to the recommendations made in this report.

*Recommendation 10: Submit a report in March of 2003 addressed to the Blue Ribbon Committee on Finances summarizing the progress on each recommendation contained in this report.*

## CONCLUSION

The City is basically fiscally sound. San Diego operates within a restricted revenue base, its revenues per capita are lower than most major cities in the United States. San Diego operates within the restrictions of the Peoples Ordinance-adopted in a different era which precludes the collection of fees for residential trash collection. The City does not utilize some revenue sources such as Utility User Tax, Residential Trash Collection Fees, and Water/Sewer Utility Right-of-Way fee used by other California cities to offset the restrictions of Proposition 13.

San Diego, as with any governmental entity, has fiscal demands, which exceed current funding sources. While other cities have entered into higher levels of debt, San Diego has maintained an acceptable level of debt, and as a result has retained a positive credit rating over the years. Over the next few years, the City proposes increases in debt. These increases are planned to be mitigated by growth in existing revenue sources such that debt service as a percentage of revenues is only increasing by less than 1 percentage point.

However, there are some serious concerns, which the Committee felt needed to be brought into full focus and addressed by the City Council. These issues were long in their creation and certainly were not the product of the current City leaders. Nonetheless the incumbent Administration must publicly recognize the issues and develop to a plan deal with them.

First and foremost, operating within the restrictions identified above, decisions have been made over the years to defer physical infrastructure requirements in favor of more visible or other pressing needs. While this is a difficult issue to accurately quantify, City staff estimates unfunded deferred maintenance exceeds \$300 million. Deferred maintenance is a somewhat illusive issue in that reasonable people can differ on what is truly "needed" versus what is "nice to have". Similarly with Information Technology, what is truly needed in this rapidly changing world versus what is truly cost justified is often debated. But in any event, the City must visibly acknowledge this serious problem, accurately quantify it, and develop a financial plan to remedy the problem over a specified period of time.

The second concern is that, analogous to the "deferred maintenance", the City is likewise partially deferring until later years the recognition of currently incurred cost for pensions and retiree health benefits (i.e. earned by current employee to be collected in later years). The City is not having current year's taxpayers pay for all the pension and retiree health benefit costs that are earned in that year. This is placing a growing burden on future years' taxpayers.

Third, the City has been prudent over the last five years in recognizing the need for a reserve for unplanned "crises". As a result, reserves have gradually been built over the last few "boom" economic years, but the magnitude of it is still significantly less than other municipalities find prudent. The Committee encourages the City to continue to build these reserves up to at level of 7-10% of General Fund Revenues.

A further concern is the current economic conditions both locally and statewide. The current recession can have a material impact on City revenue in the near term. This means a concerted effort must be made now to control expenses and further improve operating efficiencies.

The Committee feels it is incumbent on the City to develop a long range financial and operations plan to address the issues raised in this report and to fully apprise the public of the issues and of the plans. It is anticipated that the financial plan would include a combination of increasing the current revenue base, obtaining additional revenue sources, and controlling/reducing expenditures.

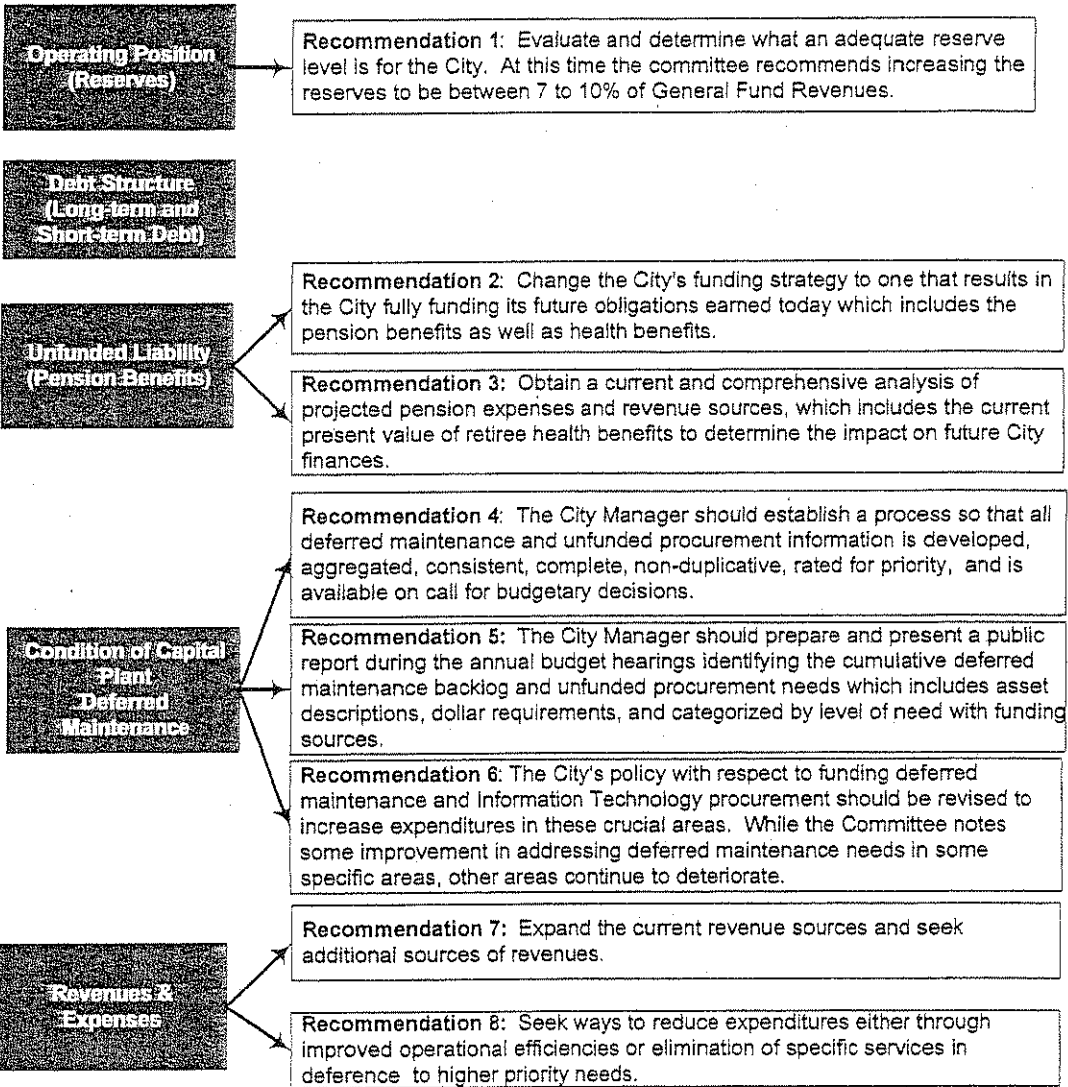
Finally, the Committee requests that the City respond to the recommendations contained in this report in March of 2003, at which date, the Blue Ribbon Committee will reconvene to evaluate the City's progress on each recommendation.

In conclusion, the Committee believes San Diego has earned the self-proclaimed title of America's Finest City and that the City is poised to perpetuate that title. How well the City deals with the issues raised in this report will play heavily in how deserved that title will be in the future as well as the Mayor's goal of being a "*City worthy of our affection.*"

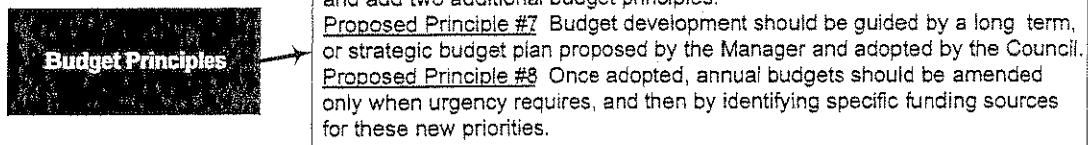
# BLUE RIBBON COMMITTEE ON CITY FINANCES SUMMARY OF RECOMMENDATIONS

## Financial Factors

## Committee Recommendations



## Organizational Factors



## Follow-up Recommendation

Recommendation 10: Submit a report in March of 2003 addressed to the Blue Ribbon Committee on Finances summarizing the progress on each recommendation contained in this report.

## I. GENERAL RESERVES AND INSURANCE

### A. GENERAL RESERVES

Reserves are an integral part of the City's fiscal health. The size of a local government's reserve balance can affect its ability to withstand financial emergencies. It is important for the City of San Diego to have sufficient funds in reserve that are available in a time of fiscal crisis. While reserves may never be sufficient to cover one-time occurrences such as large judgments or physical catastrophes, they should be sufficient to cover unplanned circumstances such as short-term economic downturns.

It is important to distinguish between General Reserves and the General Fund Reserve. General Reserves are total funds set aside and are readily available in the event of a crisis. The General Fund Reserve is an amount set aside within the General Fund and is only one component of the total reserves. At the start of Fiscal Year 2002, total General Reserves are \$30.5 million as summarized below:

General Fund Reserve	\$19.5 million
Convention Center Reserve	6.9 million*
MTDB/Trolley Reserve	2.1 million*
GASB 31 Reserve	<u>2.0 million*</u>
Total General Reserves	<u>\$30.5 million (a)</u>

- (a) Upon issuance of the Downtown Ballpark Development Project lease revenue bonds, this total will increase to approximately \$35.9 million as a result of replenishing the Balboa Park Reserve and creating a Ballpark Reserve. In Fiscal Year 2004, an additional \$4.7 million will be added to the Ballpark Reserve.

\*These reserves are not restricted and may be used for general purposes.

The City's General Reserves of \$30.5 million, is approximately 4% of the Fiscal Year 2002 General Fund revenues. Historically, the General Reserves have more than doubled since 1997. The table below shows the total balance of the General Reserves at June 30<sup>th</sup> for the last five years. As illustrated, these reserves have been steadily increasing.

FISCAL YEAR	GENERAL RESERVES BALANCE (MILLIONS) <sup>1</sup>
2001	\$30.5
2000	\$26.3
1999	\$16.4
1998	\$14.8
1997	\$12.5

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1. Includes the General Fund Reserve, Convention Center Reserve, MTDB/Trolley Reserve, Balboa Park Reserve and GASB 31 Reserve

The Committee applauds the fact that the City has increased general reserves substantially in recent years and recommends the City continue to increase general reserves until they are in the 7-10% range of General Fund revenues.

## **B. INSURANCE**

The City has a risk management program for nonrecurring liabilities, which is managed by its own Risk Management Department. The City is 100% self-insured for all claims involving worker's compensation, and certain group health benefits and long-term disability. For general and automobile liability, the City is self-insured up to \$1,000,000 per occurrence and has excess liability insurance through a Comprehensive Liability Insurance program for claims exceeding \$1,000,000 up to a maximum of \$54,000,000 per occurrence effective August 9, 2001. In addition, for those capital assets (e.g., buildings and structures) for which insurance is appropriate, the City also has insurance coverage, which covers nearly all City-owned buildings for the replacement value of the building or structure. Earthquake insurance has also been secured for selected buildings and structures according to criteria established by the City. (Buildings built by means of a bond issue have earthquake coverage.) The City's Risk Management Department, in conjunction with the City Attorney's Office, determine the probable cost of claims against the City for any given year. The City has carried excess liability insurance for the past eleven (11) fiscal years for which period the City has not settled any claim exceeding its excess liability insurance coverage of \$54,000,000. The Risk Management Department and the City Attorney's Office have evaluated all current outstanding claims against the City.<sup>2</sup>

## **Conclusion**

The Committee found that as of June 30, 2001, the City's General Reserves were \$30.5 million or approximately 4% of the total General Fund Revenues. While reserves may never be sufficient to cover such one-time occurrences as large judgments or physical catastrophes, they should be sufficient to cover unplanned circumstances such as short-term economic downturns. The Committee also found that the City has adequate insurance to cover such items as: worker's compensation, certain group health benefits and long-term disability, earthquake, general liability, and automobile insurance.

*Recommendation 1: Evaluate and determine what an adequate reserve level is for the City. At this time, the Committee recommends increasing the reserves to be between 7 to 10% of General Fund Revenues.*

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<sup>2</sup> There is an outstanding judgment against the City in excess of its policy limits, which is currently on appeal.



## II. LONG TERM DEBT

The Committee reviewed the City's Long Term Debt with the objective to:

- Review and obtain an understanding of the City's current Long Term Debt Obligations
- Review the City's Debt Service and the impact of the proposed bond issuances for the Ballpark, Fire Stations, and Library System

Our review was limited to an analysis of the City's General long-term debt. The City's water and sewer bonds, which are paid directly by user fees, are not included in this analysis.

### A. CURRENT GENERAL LONG TERM DEBT

The City's General long-term debt as of June 30, 2001 was \$452 million consisting of General Obligations Bonds (14%), Lease Revenue Bonds (73%), and Certificates of Participation (13%). General Obligation Bonds are bonds subject to the approval of a two-thirds vote and secured by the City's full faith and credit. Lease Revenue Bonds and Certificates of Participation obligations of the City are secured by an installment sale agreement or by a lease-back arrangement with a public entity lease. The City pledges general operating revenues to pay the lease payments.

	Principal Outstanding June 30, 2001	Funding Source
<b>General Obligation Bonds</b>		
1994 Open Space Park Facility Refunding	\$45,520,000	Property Tax & Franchise Fees
1991 Public Safety Communications	<u>\$18,075,000</u>	Property Tax
<b>General Obligation Bonds</b>	<b>\$63,595,000</b>	
<b>Certificates of Participation</b>		
1993 Balboa Park/Mission Bay Improvements	\$21,040,000	Transient Occupancy Tax
1996A Balboa Park/Mission Bay Improvements	\$26,975,000	Transient Occupancy Tax
1996B Balboa Park/Mission Bay Improvements	\$10,720,000	Transient Occupancy Tax
1991 Misdemeanor/Pre-arraignment Detention Facility	<u>\$ 1,900,000</u>	Sales Tax
<b>Total Certificates of Participation</b>	<b>\$60,635,000</b>	
<b>Lease Revenue Bonds</b>		
1993 City/MTDB Authority Old Town Trolley Extension	\$16,430,000	Transient Occupancy Tax
1994 City/MTDB Authority Refunding Bayside Trolley and 1994 City/MTDB Authority Refunding -Police Improvements	\$40,505,000	Transient Occupancy Tax Sales Tax
1996 Qualcomm Stadium Improvements	\$65,905,000	Stadium Revenues
1998 Convention Center Expansion Authority	<u>\$205,000,000</u>	Transient Occupancy Tax
<b>Total Lease Revenue Bonds</b>	<b>\$327,840,000</b>	
<b>Total General Obligation/General Purpose Bonds</b>	<b>\$452,070,000</b>	

Source: City of San Diego Comprehensive Annual Financial Report, 6/30/01

The City is proposing bond issuances for the following three major projects:

Project	Fiscal Year	Proposed Principal (1)	Funding Source
Ballpark/Redevelopment District	2002	\$224,790,000	Transient Occupancy Tax
Fire Station Improvement Phase 1	2002	\$ 18,465,000	Sales Tax
Library System	2003/2004	\$149,175,000	Transient Occupancy Tax
<b>Total</b>		<b>\$392,430,000</b>	

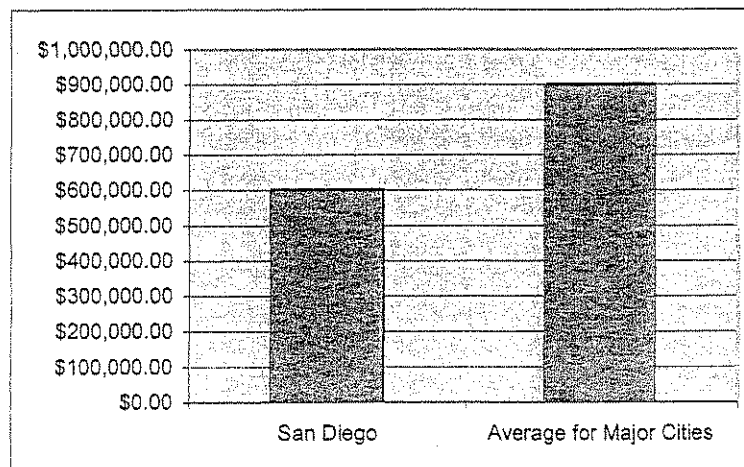
*Footnote (1): The proposed issuance sizes were as of June 22, 2001. The final figures will likely be somewhat different. As an example, the Ballpark Redevelopment District will likely drop by approximately \$55 million. However, since the Library financing will now be system wide, it will likely increase by a similar amount.*

### 1) Legal Debt Limit

Section 90 of the City Charter prohibits the City from issuing general bonded indebtedness in excess of the 10% of the Assessed Value of all Real and Personal Property in the City. As of June 30, 2000, the debt limit for General Fund bond was \$2.1 billion. As of June 2000, the City was well below the legal limit and is expected to continue to be below the limit with the proposed bond issuances described above. It should be noted that lease obligations do not count towards that limit since, by legal definition, they are not long term debt of the City but rather are subject to annual appropriation.

### 2) Comparison Of Total Debt (Including Lease Revenue, Certificates Of Participation, and Tax Allocation Bonds) To Other Major Cities

As of August 2000, the average debt for the Nation's largest populated cities was \$900 million. The City's debt was below the average with total debt at \$600 million.



Source: Moody – The Nation's Largest Cities: Comparative Data, August 2000

### 3) Net Direct Bonded Long-Term Debt as Compared to Assessed Valuation

The City's debt levels as a percentage of all assessed taxable property in the City of San Diego excluding Redevelopment Projects was well below the median as compared to other major metropolitan California cities. The median debt as compared to assessed value in Fiscal Year 1999 was 1.1%. As illustrated below, the City's direct debt remained and is forecasted to remain below 1% through Fiscal Year 2005. See Attachment 4.

**Long-Term Debt as a Percent of Assessed Valuation  
Fiscal Years 1997-2005**



### B. DEBT SERVICE ANALYSIS

Debt service is the amount of principal and interest allocated each year for the payment of long-term debt. Our analysis included comparing yearly debt service to revenues and to expenditures. The City's debt service in Fiscal Year 1997 was \$20 million. It increased to \$40 million in Fiscal Year 2000 and is expected to increase to \$60 million by Fiscal Year 2005.

#### 1. **Effects of the Ballpark, Fire Station, and Library System Issuances on Debt Service**

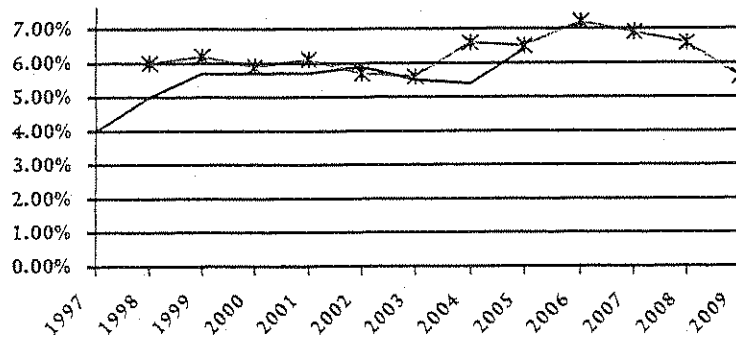
##### As a Percentage of Expenditures

The City's debt service between Fiscal Years 1998 to 2000 was approximately 6% of the total general fund expenditures. In Fiscal Year 2006, the percentage is estimated to increase to 7% with the issuances of the proposed bonds for Ballpark, Fire Stations and the Library System. As older bonds are paid off, it is projected that this percentage will decrease to 5% by year Fiscal Year 2009.

##### As a Percentage of Revenues

The City's net direct debt service levels as a percentage of general purpose revenues has remained relatively constant since Fiscal Year 1999 at 5.7%. By year Fiscal Year 2005, this percentage is forecasted to increase by less than one percentage point mainly due to the proposed issuances mentioned above. See Attachment 5.

### Debt Service Analysis Fiscal Years 1997-2009



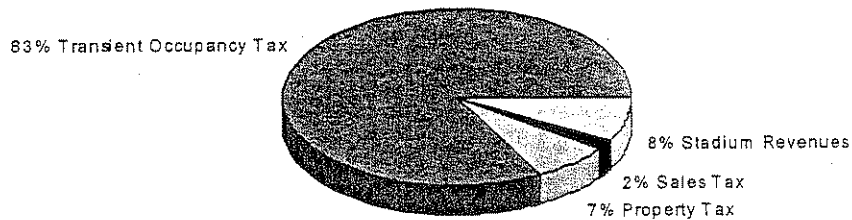
*Top line reflects debt service as a percentage of expenditures, bottom line, which begins at 4% in Fiscal Year 1997, reflects debt service as a percentage of revenues.*

#### C. FUNDING SOURCES OF DEBT SERVICE

Without pledging specific sources of revenue, except for general obligation bonds, the City attempts to identify sources of funds for repayment of general City debt service before it issues such debt.

As illustrated below, the primary expected revenue source for general City debt service, based on Fiscal Year 2003 estimated long-term debt is Transient Occupancy Tax, which comprises approximately 83% of the total. Property taxes consist of 7%, Stadium revenues, 8%, and Sales Tax 2% of these estimated payments.

### Sources of Debt Service Fiscal Year 2003



The fact that one expected revenue source is approximately 83% of the total was an early concern. Further inquiry and analysis revealed that the 20-year average annual growth rate for TOT revenues has been 11%. In addition, the amount of TOT revenues allocated to capital improvement debt service is only 33% of the total annual TOT. Further, there are other funding sources available for repayment of the bonds in the event TOT falls short. These are as follows:

- City's Internal Stability Reserves – A half of one year's debt service for each bond issue is set aside in these reserve accounts.
- Other Revenue – General Lease Obligation's debt service is a pledge against the City's general funds. As a consequence, any general fund source can be used. In each of the last four fiscal years, General Fund revenues exceeded budget by at least \$22 million.

#### **D. FAVORABLE BOND RATINGS**

Our analysis included a review of the City's bond ratings by major Rating Agencies. Moody's ranked only six of the largest 32 cities in the nation higher (AAA) than the City of San Diego for its General Obligation rating and stated the "Key to the City's rating is its judicious use of debt, including careful identification of repayment of sources prior to debt issuance." Moody's rated the City's General Obligation Bonds with a Aa1 rating – high quality and very strong capacity to pay principal and interest.

Prior to the passage of Proposition 218 in 1996, Moody's rated the City AAA, the highest of any large city in California. In the aftermath of Proposition 218, Moody's lowered the rating of most California cities, one notch due to financial constraints imposed on all local governments in California. Consequently, the City's rating was lowered one notch to Aa1. Notwithstanding the reduction, the City of San Diego continues to have the highest rating among large California cities.

Standard and Poor's also gave the City a favorable rating. Its July 24, 2001 article stated "The City's very strong general credit characteristics, including a rebounding and diversified economy with improved property value growth; strong financial management; and a moderate debt burden, with manageable anticipated additional debt issuance."

*(See Attachments 2 and 3 for State and National rating comparisons and rating definitions)*

#### **Conclusion**

The Committee found that, historically, the City's total debt outstanding, as well as total debt compared to assessed property valuation, has been well below the median of other major cities. The City's debt service has remained constant as compared to expenditures and revenues and is expected to increase only minimally with the proposed addition of the Ballpark, Fire Stations, and Library System bond issuances. Although the primary expected revenue source for approximately 83% of the general City debt service is TOT, the City has alternate funding sources to repay the debt. Finally, Moody's and Standard and Poor's in their detailed bond rating process gave the City of San Diego favorable ratings which reflects the City's ability to repay its long term debt obligations.

### III. RETIREMENT BENEFITS AND UNFUNDED PENSION LIABILITIES

All full time City employees participate in the San Diego City Employee Retirement System (SDCERS), which is the City's Defined Benefit Pension Plan. As a defined benefit plan, retirement benefits are determined primarily by a member's age at retirement, the length of membership service and the member's final compensation earnable based on the highest one-year period.

The level of retiree benefits is a policy issue. The question to be addressed by the Committee is how these benefit policies affect the fiscal health of the City. The Committee did not address the issue of how the City's pension assets are invested.

Employee retirement benefit liabilities of the City comprise two issues:

- Pension Benefits
- Retiree Health Benefits

#### A. PENSION BENEFITS

The Committee has two concerns regarding the Retirement Benefit Liability:

1. *Whether the City is paying out of its current year's budget the full cost being incurred by its current workforce for their future pension and retiree health benefits.*
2. *Whether the budgetary process adequately comprehends the steadily growing annual expense obligation, particularly given the uncontrollable and non-discretionary nature of this liability.*

The potential risk is that policy makers grant benefit enhancements today (to satisfy employee concerns, to negotiate trade offs with unions, etc.), but avoid recognizing the actual annual cost of such by actuarially spreading the cost over years far out in the future, long after the individuals who made the policy decisions are gone. This is particularly acute where the retiree benefit enhancements are granted "retroactively", i.e. new improved benefits, which are applied to past, as well as future, years of service for active employees. This retroactive approach is the general practice of the City.

Major pension improvements (20% increase) were implemented in Fiscal Year 1997 and benefits were increased by another 12% in Fiscal Year 2000 as a result of a litigation settlement. San Diego County is in the final stages of approving major pension improvements, exceeding San Diego City benefits. This will undoubtedly lead to pressure for further increases for City employees.

The City's annual cash contribution expense for pension was \$68 million for Fiscal Year 2001. This is one of the larger items in the City's overall budget. Further, this expense line item has been growing at about a 9% per year compound rate the last five years and at a much faster rate if measured back 10 years.

The chart below shows that the annual cash contribution to the Pension Trust Fund has been steadily increasing faster than the underlying payroll base. This is a serious concern.

Fiscal Year	Payroll Base (In millions) (a)	Cash Contribution to Pension Trust Fund (in millions) (b)	Cash Contribution as Percent of Payroll Base (b) / (a) <sup>3</sup>
1992	\$313	\$27.4	8.8%
1993	\$321	\$31.2	9.7%
1994	\$338	\$34.6	10.2%
1995	\$351	\$38.6	11.0%
1996	\$365	\$43.7	11.9%
1997	\$383	\$47.5	12.4%
1998	\$399	\$51.0	12.8%
1999	\$425	\$55.4	13.0%
2000	\$449	\$60.7	13.5%
2001	\$479	\$67.6	14.1%

The City has an unconventional actuarial driven plan that has the City's annual cash contribution for pension benefits (i.e. budget expense) to the SDCERS Trust Fund increasing a half percentage point of total payroll base each year until the actuarial formula is in balance. This half point step increase each year could go on for years, how many years depending on actual pension fund results versus actuarial assumptions.

The following example illustrates the magnitude of this situation:

- Fiscal Year 2001 expense was \$68 million.
- If payroll dollars increase 6% per year, due to inflation plus staff growth, and the .5% increase in pension expense rate continues for at least five years, then Fiscal Year 2006 expense would be \$106 million, a 57% or \$38 million increase. And this is a non-discretionary item in the budget. Any improvements in pension benefit granted in the future, particularly if they apply to past service, will significantly exacerbate this problem.

## **B. RETIREE HEALTH BENEFITS**

Of equal concern is the "unfunded" retiree medical liability. Retiree health benefits are, as of a 1996 citizen vote, effectively being paid out of the SDCERS Trust Fund on a cash incurred basis (as distinct from the expense being accrued and actuarially cash flow funded annually when the benefits are earned). Fiscal Year 2000 retiree health benefit expense was \$5.4 million. Fiscal Year 2001 was \$7.2 million, a 33% increase. While this expense line item is much smaller than the pension expense, it might be a false comfort and therefore misleading. The amount of the total unfunded retiree medical liability is not

<sup>3</sup> Resulting percentage varies from an actuarially mandated .5% per year increase due to varying amount of employee contributions paid for by the City.



addressed in SDCERS or City financial documents. The actual annual, budgeted expenditure for this binding obligation appears to be an "indirect" part of the actuarial computation to develop the annual pension cash contribution. The City's practice is in accordance with current Generally Accepted Government Accounting Principles (GAAP). However, 12 years ago GAAP was changed for private industry to require the recognition annually of the cost of future retiree health benefits being "earned" that year by the current work force. The reason for this accounting change was the growing concern over the very sizeable liabilities for future payments that were not being fully recognized.

The Committee recognizes the City has the potential for this same problem, i.e. a sizeable, growing liability for future payments. The City has a growing workforce, an early age for retirement (50 for Public Safety employees and 55 for General employees), a lengthening of life spans, and an ever increasing cost of health care. As a consequence, retiree medical costs represent a "non-discretionary" expense, which will grow faster and most probably much faster, than the current employee salary base in the City budget.

While this retiree medical cost is currently a relatively small budget item, it will most likely grow at an increasing rate, in essence for costs of prior years' employee service. It is conceivable this liability at today's present value could exceed \$100 million. It is unclear how well the City policy makers appreciate this overall expense issue and how it will affect the City budget in the future.

### **C. FUNDING LEVEL**

SDCERS is not in a fully funded position. It is currently funded at 97% (i.e. its current assets equaled 97% of the actuarially computed present value of the future Pension Plan liabilities). The absolute dollar amount of under funding hit a peak of \$148 million in Fiscal Year 1999. Excellent Pension asset investment performance reduced that unfunded liability to \$69 million in Fiscal Year 2000. However, investment performance in Fiscal Year 2001 was less than half of the excellent performance in Fiscal Year 2000. Investment performance in the first seven months of Fiscal Year 2002 is lower than in Fiscal Year 2001. It is expected that the forthcoming actuarial report will show an increase in the unfunded dollar amount.

### **San Diego City Employees' Retirement System Financial Information For Fiscal Years 1996 - 2001 (\$ IN MILLIONS)**

	2001	2000	1999	1998	1997	1996
Pension Fund Assets	\$2,807	\$2,999	\$2,476	\$2,272	\$1,855	\$1,604
City Pension Expense	\$68	\$61	\$56	\$51	\$48	\$44
Pension Plan & Health Benefits Paid	\$155 <sup>1</sup>	\$112	\$100	\$85	\$67	\$62
Unfunded Actuarial Accrued Liability	Not available	\$69	\$148	\$125	\$117	\$140
Retiree Health Benefits Expense	\$7	\$5	\$5	\$4	\$5	\$5

<sup>1</sup> includes \$24 million Corbett pay out settlement.

## Conclusions

1. The City is not paying out of its current year's budget the full cost being incurred by its current workforce for their future pension and retiree health benefits. As a result, a portion of the cost of today's City workforce will be paid by future year's taxpayers. As compared to an alternative, GAAP approved actuarial method, current annual expense has a shortfall of approximately \$6-8 million. The cumulative short fall, for Fiscal Years 1997-2000, is \$31 million.
2. The City is experiencing a dramatic, steady increase in non-discretionary pension expense. This is due to the large benefit increases granted to employees by the City. The chart on page 21 illustrates that annual pension expense in Fiscal Year 2001 was 14.1% of payroll compared to 8.8% in Fiscal Year 1992. Worse, this 14.1% is artificially low since (per #1 above) the City is not paying the full cost of the pension benefit being earned each year. The 14.1% will continue to grow by at least a half percentage point each year. The Committee is very concerned whether the City fully appreciates the impact these increasing expenses have, (and particularly any future improvements in pension benefits granted to employees will have) on future annual City budgets.
3. This City is potentially building up a sizeable non-discretionary liability for retiree health benefits, the magnitude of which is not well recognized in the City's budgetary process.
4. A point of possible concern is that after an unprecedented 9-year boom in the equity market when many pension plans became flush and actually over funded, allowing the sponsors to reduce annual cash contributions, the City still has an unfunded liability. This, taken together with the growing annual liability for the "retroactive" pension improvements is a cause for concern.

## Recommendations

*Recommendation 2: Change the City's funding strategy to one that results in the City fully funding, on a current basis, its future obligations earned today which includes the pension benefits as well as health benefits.*

*Recommendation 3: Obtain a current and comprehensive analysis of projected pension expenses and revenue sources, which includes the current present value of retiree health benefits to determine the impact on future City finances.*

In regards to the above recommendations, the City should determine, as a part of the comprehensive analysis, how many years in the future the City's pension contribution expense will increase by a half percentage point of the total payroll base if it stays with the current funding method or will a large increase be required.

The City should also be apprised of the current present value of the unfunded retiree health benefits. A simulation model should be run to determine whether/how soon the City might have to add a separate budget line to pay health benefit costs out of annual cash flow rather than out of the SDCERS Trust Fund as at present. Further, the Retirement Board/City should consider funding this liability each year on an actuarial basis as it is earned by the current employees rather than the present method of waiting until employees retire and then funding the actual cost. The Committee recognizes this is in competition with its recommendations to fund general deferred maintenance and increase reserves.

#### **IV. GENERAL DEFERRED MAINTENANCE AND UNFUNDED PROCUREMENT**

One of the foremost items affecting the fiscal health of the City is the condition of its infrastructure including physical deterioration and obsolescence.

Physical assets require periodic major maintenance. Major maintenance items are capital in nature and would include replacing roofs, boilers, pipes, pumps, interior ceilings, re-paving streets, parking lots, etc. Major maintenance projects should be able to be scheduled out over a multi-year period. If the replacement and maintenance schedule of these major items are not met, then they become an item of deferred maintenance.

In theory, the backlog of deferred maintenance projects should be identifiable and the dollars quantifiable. Further, a plan should exist to "work off" any deferred maintenance backlog with the ultimate goal being to perform all major maintenance on schedule.

While a deferred maintenance backlog does not necessarily mean that assets are in a dangerous state of disrepair, the importance of performing major maintenance projects on schedule cannot be understated. As any property owner is aware, periodic maintenance significantly reduces overall maintenance costs since the very goal of scheduled maintenance is preventative.

This is also true of deferred unfunded procurement. Some assets, such as computer equipment, are subject to obsolescence or reach a point where maintenance is no longer cost effective such as in the case of vehicles.

The Committee focused on the non-Enterprise funds for deferred maintenance. The Enterprise Funds for Airports, Environmental Services and Golf Courses reported that they either do not have any significant deferred maintenance issues or have funding plans to deal with them. See Section V for a discussion of capital and future needs related to Water, Wastewater, Storm Water and the Multiple Species Conservation Program.

The Committee asked the City Manager's Office to estimate deferred maintenance and/or procurement needs in the areas of Streets, Alleys, Sidewalks, Street Light and Traffic Signals, Bridges, Buildings and Structures, Fleet, Coastal Infrastructure and Facilities, and Information Technology.

The Committee was advised that the Fiscal Year 2002 budget specifically identified \$11.4 million as a budget increase for ongoing maintenance in the areas of streets, fleet replacement, and general infrastructure improvements.

The following information gives details behind the five major categories of deferred maintenance and unfunded procurement identified by the Committee:

- Streets, Alleys, Sidewalks, Street Lights and Traffic Signals, and Bridges
- Buildings and Structures
- Fleet
- Coastal Infrastructure and Facilities
- Information Technology

**A. DEFERRED MAINTENANCE**

**1. Streets, Alleys, Sidewalks, Street Lights And Traffic Signals, And Bridges**

A memorandum dated October 29, 2001 from the Street Division on the status of the deferred maintenance cites the dollar amount of the current backlog for streets, alleys, sidewalks, street lights, traffic signals and bridge repair as \$163 million as shown below.

Streets	\$139 million
Alleys	\$ 10 million
Sidewalks	<u>\$ 8 million</u>
Subtotal	<u>\$157 million</u>
Street lights/signals	\$ 5 million
Bridges	<u>\$ 1 million</u>
Total Estimate	<u>\$163 million</u>

A separate Manager's Report on the status of the City's streets and sidewalks was presented to a City Council Committee on April 25, 2001 and the report was updated in October. This report did not include information on street light/signals nor on bridges. According to the report, at the current rate of funding, the backlog of deferred maintenance on streets, alleys and sidewalks would be \$245 million within five years. This increase of \$88 million results both from an increase in the number of miles of pavement needing maintenance and from the fact that deferral of the \$157 million is resulting in ever-increasing maintenance costs.

It is also important to note that only streets and alleys have had a comprehensive status assessment. Sidewalks, bridges, and street lights are only included in the backlog list if they are reported by citizens or noted by staff when in the area.

**2. Buildings And Structures**

A report is currently being prepared quantifying the backlog of deferred maintenance on buildings and structures. A very preliminary draft of this report indicates the amount is approximately \$65 million. This is a reduction from the 1998 estimate of \$93 million.

Because the report is not yet complete, it is not possible to determine the actual methodology used to make these calculations. Upon completion, the report should be thoroughly reviewed and

compared to other available estimates. For example, the total costs included in the draft report for the City Administration Building is less than \$1 million. A recent estimate by Gruen Gruen + Associates, however, identifies the cost of asbestos removal, deferred maintenance and the Americans with Disabilities Act (ADA) requirement upgrades for the building at \$6 million.

It is also not possible to determine which deficiencies are being included in the estimate. For example, it appears that asbestos abatement, ADA compliance measures, parking lots (except for the downtown parkade) are not yet included for any of the buildings. The draft report itself indicates that the amounts shown for police and fire buildings are not current.

The draft preliminary list does include deferred maintenance on libraries, but does not make clear the effects of related library expansions (some expansions may obviate the need for deferred maintenance).

The draft preliminary list does not lend itself to a calculation of an annual shortfall. This would require preparation of a prospective schedule of major repair and replacement needs.

### **3. Fleet**

A report dated November 28, 2000 prepared by DMG-Maximus, Inc. was provided to the City of San Diego. The report identified a \$58 million deferred purchase (fleet replacement) backlog. According to the report, the backlog was increasing by \$9 million per year. It is important to clarify that this level of deferred purchases does not mean the fleet is unsafe. It does mean that some vehicles are past their normal service life and that failure to make these purchases is unnecessarily costing the City extra money for maintenance.

Of the total, \$16 million pertains to police vehicles. We are informed that the Police Department is working on, but has not completed, a plan to fund this backlog.

Of the total, \$27 million pertains to fire vehicles. The Fire Department has a five-year plan beginning in Fiscal Year 2001. However, nothing was purchased in the first year (2001). Both Fiscal Years 2001 and 2002 purchases are to occur in Fiscal Year 2002 through lease purchases.

The remaining \$15 million pertains to other vehicles maintained by the Equipment Division. The Manager has prepared a plan for Fiscal Years 2002-2011, which, if fully funded, would replace the vehicles as necessary.

### **4. Coastal Infrastructure And Facilities**

We reviewed a report called the "Coastal Infrastructure and Facilities Needs List" dated June 11, 1999. The report indicated a total backlog of approximately \$21 million.

Some of the items contained in the report appear to be strictly related to coastal erosion. Other items like the implementation of a master plan for Sunset Cliffs Park do not appear to be items of deferred maintenance. Still others appear to be duplicates of items found in the draft buildings/structures report.

Approximately \$1.5 million is being annually allocated to this need. We were unable to determine from the report whether the annual allocation was resulting in an actual decrease to the backlog.

## **B. UNFUNDED PROCUREMENT**

### **1. Information Technology**

A strategic plan to determine the City's goals and objectives with respect to Information Technology (IT) went to the City Council on January 28, 2002. Based on the report, total estimated IT needs are estimated to be up to \$170 million which includes an emergency communication system for an estimated cost of up to \$50 million. The majority of the \$170 million is not deferred maintenance but rather is identified needs resulting from a combination of improving technology and early anticipation of future needs over the next 2-5 years.

## **Conclusion**

The Committee believes that the City's backlog of general deferred maintenance exceeds \$300 million and the City has \$170 million of Information Technology needs which is mainly for unfunded procurement.

*Recommendation 4: The City Manager should establish a process so that all deferred maintenance and unfunded procurement information is developed, aggregated, consistent, complete, non-duplicative, rated for priority, and is available on call for budgetary decisions.*

*Recommendation 5: The City Manager should prepare and present a public report during the annual budget hearings identifying the cumulative deferred maintenance backlog and unfunded procurement needs which includes asset descriptions, dollar requirements, and categorized by level of need with funding sources.*

The report should answer the following questions for each area of consideration:

- 1) If the entire backlog in this area could be funded today:
  - a. What would that dollar amount be?
  - b. How much money would need to be annually allocated to stay current on scheduled major maintenance if the backlog was eliminated?
- 2) Is there a current plan to "work off" the backlog? If so, what are the funding sources and timeframe?

*Recommendation 6: The City's policy with respect to funding deferred maintenance and Information Technology procurement be revised to increase expenditures in these crucial areas. While the Committee notes some improvement in addressing deferred maintenance needs in some specific areas, other areas continue to deteriorate.*

## V. WATER, WASTEWATER, STORM WATER AND MULTIPLE SPECIES CONSERVATION PROGRAM

The committee believes that an evaluation of the fiscal health of the City would not be complete without considering major fiscal areas the City will face in the near future.

The Committee focused on four major areas:

- *Water*
- *Wastewater*
- *Storm water*
- *Multiple Species Conservation Program (MSCP)*

### A. WATER

#### 1. Water Availability

The City of San Diego currently uses about 230,000 acre feet (AF) of water per year. Currently, the imported water is purchased at a cost of \$439/AF for raw water and \$521/AF for treated water.

The amount increased by \$5/AF effective January 1, 2002 as a result of pass thru charges from the San Diego County Water Authority (CWA). Water supply varies in availability and price. Thus adequate storage capacity enables purchases during high availability periods when water is less costly.

On the average, the City purchases between 80-90% of its demand from the San Diego County Water Authority (imported water). The remaining 10-20% of the water is locally captured water, which is used to meet demands.

Demand growth is generally about 2% per year.

Critical components in long-term water availability involve:

- Expanded storage capacity - which is considered to be very promising
- Continued public water conservation education
- Expanded use of reclaimed water
- Exploring alternate water sources
- Ability to meet increasingly stringent water quality standards

Overall, it appears that the City is prudently moving towards increasing water availability.



## 2. Infrastructure and Price

The Water System has great infrastructure needs for both growth and rehabilitation or replacement of older system components.

The current system has up to 150 miles of old small diameter (less than 12 inches) cast iron mains. The replacement level has been in the 10-mile-per-year range at a cost of approximately \$1 million per mile. At this rate, the system will always be behind the curve. Doubling the rate to 20 miles a year would be operationally prudent, but has not been contemplated in the current business model and rate structure.

The City currently has adequate local storage to meet its normal and emergency needs and requirements to at least the year 2030.

The City also has enough storage capacity, in its local reservoirs, to take advantage of imported water programs which offer discounted water for local storage during low demand periods of the year for use during the peak demand months, such as during the summer.

The City does require additional transmission facilities, such as pipelines and pump stations, to meet emergency needs and to operate more efficiently during normal operations. To this end, the City is participating with CWA in the Emergency Storage Project. Such project will allow the City to meet its emergency needs and improve normal operations for greater savings to the City.

The City is concerned with the increasing cost of water and therefore desires to explore and study new and alternative water supplies and sources for the region. Expanded storage capacity allows the City to maximize rainwater storage and water purchases at times when the cost is low.

Plans are in the works to finance the acquisition, growth, and replacement needs of the Water System with a combination of bond issues and rate increases. An annual 6% rate increase is projected for a five-year period beginning in 2002. Two bond sales are also anticipated over the next five years.

## **Conclusion**

From a financial standpoint several areas warrant high-level ongoing attention:

- 1) *Expanding storage capacity to enable cheaper water purchases*
- 2) *Addressing the operational benefit for expanding old pipe and main replacements*
- 3) *Stimulating other revenue opportunities such as reclaimed water sales at strong margins*
- 4) *Conditioning constituents to continuous rate increases*
- 5) *Developing more finite CIP plans*
- 6) *Constant monitoring of Federal and State compliance issues*

Overall, the Committee found the main areas of concern to be water storage, price and infrastructure needs. Action plans and financing plans are in place to address these concerns. The Committee believes if the City follows through with these plans and constantly monitors compliance with mandatory requirements, the City's fiscal health will not be impacted.

## **B. WASTEWATER**

The City's Wastewater System represents a challenge relative to the fiscal health of the City for the following reasons:

- A large portion of the collection system is past its economic useful life.
- The treatment system is operating under a 5-year waiver from Federal EPA requirements for secondary treatment. That waiver is currently up for renewal. If the renewal is not granted, the City faces a multi-billion dollar capital spending requirement.
- There is a possible need in the future to expand the Wastewater System as it relates to storm water run off. This could accelerate future capital expenditures.

### **1. The Collection System**

The collection system includes about 3,000 miles of pipe of which almost 1,000 miles of said pipe is past its economic useful life of 50 years. Some of the pipe is over 100 years old. There is a high correlation between this older pipe and sewer spills. Additionally, there is higher operating cost for older pipes. Currently about 20 miles of this aged pipe is replaced per year. At this rate, it will take 50 years to complete the task. Further, it should be noted that the City pays fines for sewer spills - in the magnitude of \$4.5 million in the past 18 months. This adds to the higher overall maintenance cost of this aged portion of the system. At the current rate of

replacement, it can be expected that maintenance costs and sewer spills will continue to increase. This will in turn increase the level of monetary fines.

In recognition of the above situation, the Metropolitan Wastewater Department has proposed a major pipeline replacement, or repair where feasible, program costing \$100 million per year for 10 years. This is a doubling of the previously planned expenditure rate.

Without this newly planned enhanced capital spending program, it is unlikely the sewer spills will be reduced. This new plan will necessitate an additional 2.5% rate increase on top of a planned 5% rate increase (for normal needs like inflation) which totals a 7.5% increase each year for Fiscal Years 2002 through 2005, followed by a 6.5% increase in Fiscal Year 2006 and a 5.0% increase each year for Fiscal Years 2007 through 2010.

## **2. Treatment and Disposal**

The overall situation regarding the City treatment and disposal facilities can be labeled as quite good. The current system is in a "like new" physical condition and has adequate unused capacity to handle expected growth for at least 15 years.

However, there is one major caveat. The Treatment System is operating under a waiver from the Federal EPA Secondary Treatment requirements for the Point Loma Facility. This waiver had a 5-year life, expiring this year and was the result of extensive political debate and enabling legislation back in 1994.

The fiscal health of the City could be impacted if continued renewals of the waiver are not obtained. There is no plan to implement Secondary Treatment. Five years ago, it was estimated that the cost to do so would be about \$3-5 billion. The City believes such requirements are not required and/or not beneficial in San Diego's specific circumstance.

The currently proposed wastewater rate increases assume a waiver renewal. If the Federal EPA denied the City's application for a waiver, the City believes that EPA would grant an administrative extension to the existing waiver while the application for the renewal of the waiver is reviewed at an administrative hearing and, if necessary, in a court of law. If the waiver is not renewed, there would be an immediate need to have new facilities, which would likely be financed by long-term debt.

## **3. Storm Water Run Off**

There is some minor cross impact between Storm Water drains and the Wastewater System. In certain sensitive areas like Mission Bay, and along the coast, a low flow diversion system has been installed to take the dry weather nuisance flow, which typically has high bacteria counts, and to divert it from the normal storm drainage (which runs directly to the bay/ocean) to the sewer system.

However, there is growing concern that no storm water run off should be allowed to enter the bay/ocean without first removing the contaminants with storm water Best Management Practices.

This has the potential for being a very large and unplanned financial challenge for the City. It doesn't make sense to send storm water to the wastewater treatment facility at Point Loma for treatment when storm water treatment can be located in the area of the storm flow. Storm flows are orders of magnitude greater than sewer flows. For example, the smallest storm drain is an 18-inch diameter pipe and the average sewer main is 8-inch pipe. In addition, the contaminants in storm water are not just bacteriological and would not be removed by conventional wastewater treatment methods. Stormwater treatment methods or storm water Best Management Practices include grass swales, wetlands, detention basins, wet ponds, and filters.

There is undoubtedly some meaningful synergy between the storm drains and the Wastewater System and the City should certainly attempt to capitalize on such as they address the Storm Water problem. However, it needs be recognized that any such use of the Wastewater System will undoubtedly accelerate costly capacity additions.

## **Conclusion**

The City has a viable plan for its Wastewater System. The plan will adequately cope with the expected growth in population, while steadily reduce the number of spills. However it must be noted that the plan necessitates a 7.5% rate increase every year for the next 4 years. Additionally, the plan assumes continued "roll over" extensions of the 5-year waivers from the EPA on the treatment process.

Assuming the City maintains the waiver status, stays on track for an expanded replacement program, and achieves the support of the public for rate increases and bonds issues, the City's fiscal health will not be impacted.

## **C. STORM WATER**

Any perspective on the City's storm drain system must start with the Federal Clean Water Act of 1972 and its amendments in 1987. The Act requires cities to get permits for what comes out of their storm drain systems with the stated goal: "To reduce pollution to the maximum extent possible".

The state issues the permits, with the first ones issued in 1990. The mechanism for issuing permits is through a State Regional Board. The permit was considered to be an "early permit" because it was issued prior to the adoption of the EPA Phase I (storm water) guidelines. Although the permit renewal cycle is 5 years, a new permit was not issued in 1995.

On February 21, 2001, the Regional Board significantly revised the Municipal Storm Water Permit with the adoption of Order No. 2001-01. It is an onerous permit with very stringent requirements and very little left to the discretion of the cities.

The Order stipulates that a jurisdictional Urban Runoff Management Program document be submitted to the Regional Board by February 21, 2002 which contains a written account of the overall program to be conducted during the five-year life of the Order. The draft Urban Runoff Management Plan was presented to the Mayor's Clean Water Task Force on December 6, 2001. The plan was approved by the City Council January 28, 2002.

The City began collecting a storm drain fee from water and sewer utility customers in 1990 for the purpose of reimbursing the General Fund for costs associated with storm drain maintenance. The Storm Drain Revenue Fund is used for the operations, maintenance, capital projects and management of the storm drain system. The fee has not been increased since it was set at \$0.95 per month per residential customer by resolution No. R-27688 effective August 1, 1996. For Fiscal Year 2002, the Storm Drain Fund revenues are projected to be approximately \$6 million per year.

Within the Fiscal Year 2002 budget, \$14.6 million has been allocated for the City's Storm Water Program. The first step was to elevate the Storm Water Pollution Prevention Program to the division level within the newly formed General Services Department. With a budget of \$3.1 million, the Storm Water Pollution Prevention Program is responsible for the oversight of the Urban Runoff Management Program and compliance with the Municipal Storm Water Permit. Using \$10.2 million, the Transportation Department, Street Division is responsible for street sweeping and maintaining approximately 28,000 storm drain structures, pipes and channel. The remaining \$1.3 million was added for construction inspection, watershed coordination, and long range planning.

There are no federal funds currently available to help comply and no known legislative efforts to bring realism into the picture.

All 20 entities in the San Diego area are in the same boat in terms of scrambling to comply and are of a similar mind that some of the Regional Board mandates may well not even contribute to helping solve storm water drainage problems. But the mandates still exist.

Finally and paradoxically, the City is in the unenviable position as being the "last stop" as drain water from other jurisdictions "dumps" into the San Diego system enroute to the ocean. Thus, while the majority of the "problem" is generated elsewhere, San Diego has the biggest "fix-it" problem. No accurate data exists at this time, but the judgement is that "the vast majority of the storm drain flow in San Diego originates outside of San Diego".

The above powerfully suggests that the real and best approach to compliance with the Regional Board requirements need be done at a regional level. (Los Angeles and Orange County use the mechanism of Flood Control Districts to address their regional needs.)

In regards to the general deferred maintenance of storm drains, a memorandum to Assistant City Manager, P. Lamont Ewell, dated October 12, 2001, states a backlog need totaling \$143 million. Of the total, \$70 million is identified as needs related to 380 projects through the City for upgrade and repair to the older parts of the storm drain system and \$35 million is to replace 33 miles of corrugated metal pipe.

To address the fiscal health of the City relative to this storm drain issue, the following points are relevant.

1. Even if State mandates were relaxed, there is a significant upward cost to the City. For planning purposes, almost \$40 million per year above current revenue.

Note: To get the City to "break even" would require the City to increase the storm drain fee from \$0.95 per month to over \$7.00 per month (with equivalent increases in industrial and multi-unit fees). This is both politically horrendous and improbable, although the Council should consider some fee increase after the comprehensive plan has been developed and "sized".

2. Today's storm drain system was designed to rapidly carry flow to the ocean and be self-cleaning in the process. Tomorrow's design – based on the State's mandates - probably should be set up to take large flows of storm water to valleys or meadows to let a settling process address much of the contaminant problem.
3. More sophisticated monitoring processes are needed to gain important insight into the pollution generation problem.
4. The City must take a leadership role in the regional approach to compliance.
5. The 20 partners need to set up an effective, on-going dialog with the Regional Board so that those requirements addressed are critical to problem-solution and that others are mollified or modified.
6. Extensive public education is needed to gain the public's assistance in addressing the pollution generation problem and costs for remedial actions.
7. Proactive and vigorous efforts must be undertaken to attempt to get State and Federal assistance in addressing the problems posed by their mandates- as well as uniformity of their mandates throughout the State.

## **Conclusion**

The Committee recognizes that this new mandate presents a clear and present concern to the fiscal health of the City. If the new requirements were to be covered by increased fees, current fees would have to be increased by about 700%. If such fee increase is politically infeasible, then up to \$40 million per year must come out of other General Fund moneys. In addition the City has an estimated \$143 million in general deferred maintenance for storm drains that needs to be addressed.

#### **D. MULTIPLE SPECIES CONSERVATION PROGRAM**

The Multiple Species Conservation Program (MSCP) is a comprehensive regional plan, which will permanently preserve a network of habitat and open space in order to protect San Diego's unique environment and enhance the regions' quality of life. The plan is designed to preserve native vegetation and meet the habitat needs of multiple species rather than focusing preservation efforts on one species at a time. The MSCP provides the future infrastructure for open space while accommodating future growth and development.

The financial impact of the MSCP is estimated to be between \$334-\$411 million (1996 dollars) over the next 30 years. This includes land acquisition, management and monitoring. The "payors" include the City, the County, the State, Federal Wildlife groups and the private sector.

It is unclear who is responsible for what costs in this effort. It should be noted that in the past fiscal year, grants from the California Department of Fish and Game, the California Coastal Conservancy, the State Wildlife Conservation Board, U.S. Fish and Wildlife Service and the California Transportation Commission were involved in the effort. Collectively, City land acquisitions of \$19 million, State acquisitions of \$17 million and Federal acquisitions of \$2 million have occurred since 1994.

Thus, 50% of the total land acquisition cost was by the City, 45% by State, and 5% by Federal. Of the City amount, \$9 million was non-mitigation funding and \$10 million was through mitigating funding. Ultimately the City is proposing to acquire an additional 3,643 acres of land at an estimated cost of \$75 million to achieve Mayor Murphy's goal Number 10, "Complete MSCP Open Space Acquisitions." Annual recurring cost of land management and biological monitoring is expected to cost \$1.2 million at the completion of the land acquisition.

#### **Conclusion**

The Committee recognizes that the MSCP future cost to the City is uncertain. Therefore it is difficult to make a conclusion other than it appears that there could be a continued upward pressure of millions of dollars per year on City finances. A strong effort to secure grants for this purpose is needed to minimize the cost to the City.



## VI. REVENUES AND EXPENDITURES

### A. REVENUES

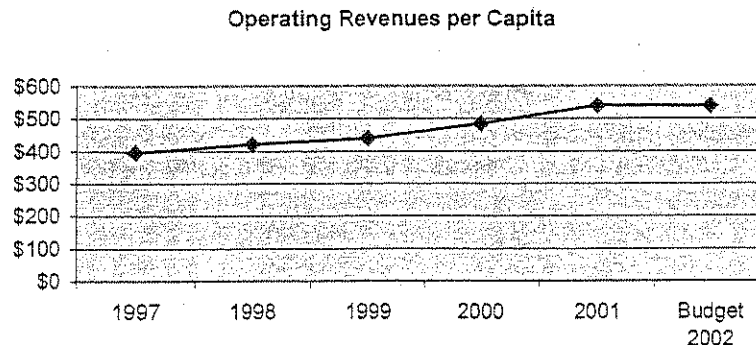
The Committee reviewed the City's General fund revenues with the objectives to:

- Identify total yearly operating revenues
- Compare to prior years and future projections, and
- Compare operating revenues per capita to other large cities.

Between Fiscal Years 1997 to 2001 total general fund revenues, on a financial reporting basis, have increased by 38% - from \$514 million to \$710 million. And is budgeted, as adjusted, on a financial reporting basis, for Fiscal Year 2002 to be \$710 million. See summary below:

Revenues:	1997	1998	1999	2000	2001	Budget 2002
Operating Revenues	\$474,310,000	\$515,241,000	\$551,003,000	\$618,580,000	\$675,100,000	\$665,115,000
Other Financing Sources	\$40,005,000	\$45,676,000	\$31,057,000	\$32,952,000	\$34,874,000	\$45,248,000
Total Revenues	\$514,315,000	\$560,917,000	\$582,060,000	\$651,532,000	\$709,974,000	\$710,363,000

We examined revenues per capita, which shows changes in revenues relative to changes in population size. As population increases, it is expected that revenues and the need for services would increase proportionately. Our analysis revealed that operating revenues per capita has been increasing over the Fiscal Years:



As compared to other cities, San Diego's Operating Revenues per Capita is lower per Moody's Fiscal Year 1999 information. See Attachment 6. As discussed throughout this report, recommendations include increasing general reserves, increasing pension funding, and increasing expenditures for deferred maintenance. In order to address these concerns the City needs to identify alternate sources of revenues and develop and implement a plan to obtain the additional revenues. For example, ten other cities in California currently collect revenues from Utility User Tax, Residential Trash Collection Fees, and Water/Sewer Utility Right-of-Way/Franchise Fee. The City of San Diego does not currently collect revenues in these areas.

## B. EXPENDITURES

The Committee found that between the Fiscal Years 1997 and 2001 total General Fund expenses increased 34% from \$521 million to \$700 million, averaging 7.7% growth per year. Budgeted increases through the Fiscal Year 2002 will bring expenses to \$745 million. The 5-year increase per annum averages 7.4%. City expenses per capita are lower than other large cities in California and the Nation. See Attachment 7.

In recent years much effort is reported on improved efficiency of operations through the Zero-Based Management Review (ZBMR) and Organizational Effectiveness programs. It is noteworthy that the City reports its service levels have generally improved during these efficiency efforts. Personnel expenses account for about 75% of the General Fund costs. Current projections forecast reductions in the rate of growth of revenues in the near term.

### Recommendations:

Recommendation 7: *Expand the current revenue sources and seek additional sources of revenue.*

Recommendation 8: *Seek ways to reduce expenditures either through improved operational efficiencies or elimination of specific services in deference to higher priority needs.*

## VII. PRINCIPLES OF BUDGETING AND FINANCE

The City of San Diego is guided by six principles in the development of its current \$2.5 billion budget. Consistent with the Mayor's direction, the Committee reviewed these principles to determine:

- *Whether they adequately addressed the needs of City taxpayers?*
- *Whether they were honored?*
- *Whether amendment is recommended?*

### A. ANALYSIS OF THE CITY'S SIX EXISTING PRINCIPLES OF BUDGETING

#### 1. *Ongoing expenditures should be supported by ongoing revenues.*

The Committee strongly supports this principle, and urges its more constant adherence. In the most recent fiscal year, the use of one-time revenues was restricted to an immaterial amount that was matched by one-time expenses.

#### 2. *The General Fund should maintain a 3% reserve of General Fund revenue.*

As of June 30, 2001, the City's unallocated General Fund Reserve was \$19.5 million, which is 2.7% of Fiscal year 2002 budgeted General Fund revenues of \$727 million. While this is a significant increase over previously budgeted reserves, it is not consistent with the existing principle.

As discussed in Section I, the Committee recommends that this principle be changed to reflect a requirement of 7-10% in total General Reserves (the current principle reflects only the General Fund's portion of total General Reserves).

#### 3. *Capital Projects should identify all future cost considerations and financial impacts.*

The Committee supports this principle, and finds that the current 12 year capital budget does generally identify some, but not all, ongoing costs.

The Committee recommends that all costs be better-approximated in future capital budgets, so that significant staffing, maintenance, and operations costs can be anticipated. This recommendation would well serve the long term strategic planning recommended above, and result in better informed decisions about how scarce resources are allocated in both the short and long term.

4. *Include direct and indirect costs for each Enterprise Fund.*

The Committee supports continued adherence to this principle. While public policy considerations may require individual adjustments in actual practice, the broad principle of identifying all costs associated with enterprise activities remains sound.

The Committee notes that until recently, a right of way fee assessed against the Water and Sewer Funds, in effect, transferred monies from the enterprise funds to the General Fund. A previous Mayor and Council voted to phase out this fee over six years. The last year it is charged is Fiscal Year 2002.

The Committee believes two important questions bear on whether the right of way fee is consistent with the principle of capturing all direct and indirect costs:

- (a) Is the purpose of the fee to recover costs associated with water and sewer line construction impacts to streets, sidewalks and other public property?
- (b) Is the purpose of the fee to also recover the value of public right of way in which water and sewer lines are placed, and is such recovery a valid "cost" to assess water and sewer rate payers? The Committee recommends that the Mayor and Council direct the City Manager to review and formulate recommendations on this matter.

5. *Activities Supported by User Fees Should Be Fully Cost Recoverable.*

In evaluating this principle, the Committee distinguished between Enterprise Fund activities, where the principle is largely adhered to, and General Fund activities, where there are exceptions. The Committee believes that the General Fund exceptions often come with good cause (e.g. access to public swimming pools for low income individuals). As such activities represent only 2% of General Fund revenues, significant research was not conducted.

The Committee recommends that the City continue to respect the broad intent of this principle, particularly with regard to Enterprise Funds, but consider amendment as it relates to General Fund activities. Such amendment could specify that full cost recovery may not always be in the public interest, but could still require identification of a specific replacement revenue source where the principal is set-aside.

6. *Discretionary General Fund revenues should not be earmarked.*

The Committee strongly supports this principle, and was troubled to note its violation, even for such a worthy cause as public libraries. The Library Council Policy requires the City Manager to include funding for library operations, maintenance and supplies in an amount that increases one-half percent each year until it reaches 6% of General Fund spending in Fiscal Year 2005. The Committee believes that a long-term strategic plan is the best way to memorialize long term commitments to important public priorities, while adherence to this principle provides the flexibility necessary to manage a large and fast changing City.

## Conclusions and Recommendations

*Recommendation 9: The City should follow its existing six budget principles and add two additional budget principles:*

*Proposed Principle #7: Budget development should be guided by a long term, or strategic budget plan proposed by the Manager and adopted by the Council.*

Addressing large capital project needs and long-term population growth require the City to have a multiple year approach to providing and funding municipal services. Development of a strategic plan for the City of San Diego would help citizens and their elected representatives better understand the public policy choices and investments required to maintain our quality of life, and offers an assurance that important long-term priorities are not lost among urgent year to year decision making. Further, strategic plans offer all parties an important opportunity to debate what San Diego should look like in future years. For purposes of better framing important public policy decisions, identifying long term City service and revenue needs, assuring attention to long term priorities, and accomplishing the highest and best uses of City tax dollars, the Committee calls on the City Manager to prepare, and the Mayor and Council to adopt, a San Diego Fiscal Strategic Plan.

*Proposed Principle #8: Once adopted, annual budgets should be amended only when urgency requires, and then by identifying specific funding sources for these new priorities.*

Sound financial and organizational management techniques dictate that once adopted, budgets should be changed only when urgently needed. When urgent circumstances, such as natural disasters or unforeseen economic slumps occur, it is imperative that specific funding be identified to accompany new priorities. Without such clarity, the legal obligation to provide a balanced budget cannot be honored, nor can spending priorities be recalibrated in the public setting taxpayers deserve. The Committee also notes that frequently changing priorities can increase the cost of City administration.

## CITY OF SAN DIEGO ACHIEVEMENTS

- The California Society of Municipal Finance Officers presented to the City of San Diego its *Excellence in Public Communication Budgeting*, *Merit in Innovative Budgeting*, and the *Excellence in Operational Budgeting* awards for the Fiscal Year 2001 Annual Budget.
- The Auditor and Comptroller was honored with a Certificate of Achievement for Excellence in Financial Reporting by the Government Finance Officers Association, and a Certificate of Award for Outstanding Financial Reporting by the California Society of Municipal Finance Officers for the City's Fiscal Year 2000 Comprehensive Annual Financial Report (CAFR).
- The Government Finance Officers Association recognized the City of San Diego for the sixth year in a row for excellence in budget presentation.
- In the "Financial Management" category, the City is praised for its comprehensive investment policies, including regular monitoring reports and strict oversight of cash management. In addition, the City's budget document is "highly readable and clearly identifies issues and goals, as well as relevant economic condition."
- Only one city was rated higher than the City of San Diego in the category "Managing for Results."
- The Government Finance Officers Association (GFOA) recognized the City of San Diego as one of four in the nation to use best practices in Financial Management. The Performance Management Program is praised in the April 2000 *Government Finance Review*:

*Comparing program and service performance with other jurisdictions allows governments to monitor their accomplishments more effectively. More importantly, intergovernmental comparisons allow governments to identify and incorporate "best practices." The City of San Diego has improved its financial management performance measurement system, and organizational performance by establishing its own benchmarking process comparing itself to similar governments.*

## CITY OF SAN DIEGO ACCOMPLISHMENTS (continued)

- On its May 2001 issues, the Reason Public Policy Institute published the results of a study of 44 of the nation's 50 largest cities. In this report, San Diego was ranked first in California and sixth overall for providing efficient government services to its citizens. The non-partisan Reason Public Policy Institute scrutinized seven years of budget and performance data to create its report, "Competitive Cities: A Report Card on Efficiency in Service Delivery in America's Largest Cities."
- At its June 2000 conference, the Government Finance Officers Association (GFOA) recognized the City of San Diego with its prestigious national Award for Excellence for the Zero Based Management Review Program. In the February 2000 edition of *Governing* magazine, 35 cities were rated in the categories of financial management, human resources, information technology, capital management, and managing for results. The City of San Diego was ranked near the top nationally in the magazine's study.
- San Diego made the top 10 of *Forbes Magazine's* Best Places in America to do business or advance one's career. Nearly 300 metro areas were measured according to wage and salary growth, job growth, and high-tech output growth, among other criteria. San Diego ranked sixth on *Forbes* list.
- San Diego is the nation's third largest "cybercity" in consumer electronics manufacturing employment, according to *Cybercities: A City-by-City Overview of the High-Technology Industry*, an analytical report by the American Electronics Association and the NASDAQ Stock Market.



**Moody's  
California's Largest Cities  
General Obligation / Issuer Rating  
Sort by Rating**

City	Population 2000	Population Rank	Moody's Rating August 2000
San Diego	1,277,200	2	Aa1
San Jose	923,600	3	Aa1
Los Angeles	3,823,000	1	Aa2
Sacramento	406,000	7	Aa2
Anaheim	310,700	10	Aa2
San Francisco	801,400	4	Aa3
Long Beach	457,600	5	Aa3
Fresno	420,600	6	A3
Santa Ana	317,700	9	A3
Oakland	402,100	8	A1

### Moody's Bond Ranking

The Moody's index consists of the following categories.

- Aaa Best quality, extremely strong capacity to pay principal and interest.
- Aa High quality, very strong capacity to pay principal and interest.
- A Upper medium quality, strong capacity to pay principal and interest.
- Baa Medium grade quality, adequate capacity to pay principal and interest.
- Ba Speculative quality, low capacity to pay principal.

In addition to the main categories, Moody distinguishes from the best to the worst bonds (1, 2 and 3) in each main category.

**Moody's**  
**The Nation's Largest Cities**  
**General Obligation / Issuer Rating**  
**Sort by Rating**

City	Population 1998	Population Rank	Moody's Rating August 2000
Dallas, TX	1,068,800	9	Aaa
Indianapolis, IN	741,304	14	Aaa
Columbus, OH	670,234	16	Aaa
Seattle, WA	536,978	23	Aaa
Charlotte, NC	504,637	26	Aaa
Portland, OR	503,891	27	Aaa
San Diego, CA	1,277,200	6	Aa1
Phoenix, AZ	1,257,451	7	Aa1
San Jose, CA	861,284	12	Aa1
Los Angeles, CA	3,597,556	2	Aa2
San Antonio, TX	1,114,130	8	Aa2
Jacksonville, FL	778,341	15	Aa2
Milwaukee, WI	608,150	20	Aa2
Memphis, TN	603,507	19	Aa2
Austin, TX	552,434	22	Aa2
Nashville-Davidson, TN	533,967	25	Aa2
Denver, CO	499,055	28	Aa2
Oklahoma City, OK	472,070	30	Aa2
Houston, TX	1,841,064	4	Aa3
Honolulu, HI	871,768	11	Aa3
San Francisco, CA	745,774	13	Aa3
El Paso, TX	637,859	18	Aa3
Boston, MA	555,447	21	Aa3
Chicago, IL	2,802,079	3	A1
Baltimore, MD	645,593	17	A1
Cleveland, OH	495,817	29	A1
Oakland, CA	396,300	31	A1
New York City, NY	7,420,166	1	A2
Philadelphia, PA	1,436,287	5	Baa1
Detroit, MI	970,196	10	Baa1
Washington, DC	523,124	24	Baa3
Miami, FL	365,548	32	Ba1

**DEBT ANALYSIS - 3-TERM DEBT**  
**Net Direct Bonded Long-Term Debt/Assessed Valuation**

	PRINCIPAL OUTSTANDING									
	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	
<b>General Obligation Bonds</b>										
Public Safety Communications, 1991	\$22,100,000	\$21,175,000	\$20,200,000	\$19,170,000	\$18,075,000	\$16,920,000	\$15,690,000	\$14,390,000	\$13,010,000	
Open Space Park Refunding, 1994	\$60,525,000	\$57,425,000	\$54,055,000	\$49,530,000	\$45,520,000	\$41,175,000	\$36,475,000	\$31,385,000	\$25,880,000	
<b>Lease Financings</b>										
<b>Certificates of Participation</b>										
Balboa Park & Mission Bay Park, 1993	\$25,485,000	\$24,440,000	\$23,355,000	\$22,225,000	\$21,040,000	\$19,800,000	\$18,500,000	\$17,140,000	\$15,715,000	
Balboa Park & Mission Bay Park, 1996A	\$33,430,000	\$32,010,000	\$30,465,000	\$28,790,000	\$26,975,000	\$25,010,000	\$22,880,000	\$20,570,000	\$18,070,000	
Balboa Park & Mission Bay Park, 1996B	\$11,720,000	\$11,485,000	\$11,240,000	\$10,985,000	\$10,720,000	\$10,440,000	\$10,150,000	\$9,845,000	\$9,520,000	
Wackenhut Correctional Facility, 1991	\$5,300,000	\$4,500,000	\$3,700,000	\$2,900,000	\$1,900,000	\$0	\$0	\$0	\$0	
<b>Lease Revenue Bonds</b>										
Old Town Trolley Expansion, 1993	\$17,960,000	\$17,600,000	\$17,225,000	\$16,835,000	\$16,430,000	\$16,005,000	\$15,560,000	\$15,095,000	\$14,605,000	
Bayside Trolley Extension/Police Facilities Refunding, 1994	\$57,515,000	\$53,900,000	\$50,120,000	\$46,170,000	\$40,505,000	\$34,560,000	\$28,320,000	\$21,775,000	\$14,890,000	
Stadium Lease Revenue Bonds, Series 1996A	\$0	\$68,425,000	\$67,635,000	\$66,795,000	\$65,905,000	\$64,955,000	\$63,945,000	\$62,870,000	\$61,720,000	
Convention Center Expansion, 1998	\$0	\$0	\$205,000,000	\$205,000,000	\$205,000,000	\$200,980,000	\$196,810,000	\$192,480,000	\$187,980,000	
<b>Proposed Issuances</b>										
Ballpark - 2001 (Estimate)				\$0	\$0	\$224,790,000	\$224,790,000	\$224,790,000	\$224,790,000	
Fire Stations - Phase 1 - 2002 (Estimate)				\$0	\$0	\$0	\$18,465,000	\$18,250,000	\$18,020,000	
New Main Library - 2003 (Estimate)				\$0	\$0	\$0	\$149,175,000	\$149,175,000	\$149,175,000	
<b>TOTAL DIRECT OBLIGATIONS</b>										
Self Supporting Debt (Public Safety Communications, 1991)	\$234,035,000	\$290,960,000	\$482,995,000	\$468,400,000	\$452,070,000	\$654,635,000	\$800,760,000	\$777,765,000	\$753,375,000	
(supported by ad valorem tax)	\$22,100,000	\$21,175,000	\$20,200,000	\$19,170,000	\$18,075,000	\$16,920,000	\$15,690,000	\$14,390,000	\$13,010,000	
<b>NET DIRECT OBLIGATIONS</b>										
NET ASSESSED VALUATION*	\$211,935,000	\$269,785,000	\$462,795,000	\$449,230,000	\$433,995,000	\$637,715,000	\$785,070,000	\$763,375,000	\$740,365,000	
NET DIRECT OBLIGATIONS/ASSESSED VALUATION	\$63,892,271,000	\$65,640,785,000	\$70,991,711,000	\$78,663,953,000	\$85,292,860,000	\$85,292,860,000	\$88,321,609,459	\$91,457,909,810	\$94,705,580,188	
	0.3%	0.4%	0.7%	0.6%	0.5%	0.7%	0.9%	0.8%	0.8%	

\*Assumes a 4.4% annual inflation rate (10 year average, 1992-2001) from FY 2002 through FY 2005.

**DEBT ANALYSIS      JT SERVICE**  
**Net Direct Debt Service/Net Operating Revenues (General Purpose Revenues)**

	DEBT SERVICE									
	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	
General Obligation Bonds										
Public Safety Communications, 1991	\$2,368,875	\$2,365,118	\$2,361,405	\$2,358,260	\$2,360,540	\$2,352,463	\$2,355,335	\$2,348,785	\$2,333,936	
Open Space Park Refunding, 1994	\$7,256,179	\$6,434,429	\$6,549,429	\$7,535,929	\$6,789,023	\$6,915,503	\$7,040,218	\$7,176,418	\$7,311,468	
Lease Financings										
Certificates of Participation										
Balboa Park & Mission Bay Park, 1993	\$2,324,900	\$2,319,828	\$2,317,208	\$2,315,670	\$2,319,713	\$2,319,375	\$2,319,825	\$2,315,630	\$2,311,685	
Balboa Park & Mission Bay Park, 1996A	\$1,333,566	\$3,070,215	\$3,135,915	\$3,199,003	\$3,262,153	\$3,324,646	\$3,390,793	\$3,460,858	\$3,530,608	
Balboa Park & Mission Bay Park, 1996B	\$485,841	\$878,088	\$878,488	\$878,296	\$877,308	\$880,310	\$877,123	\$877,610	\$881,860	
Wackenhut Correctional Facility, 1991	\$1,180,000	\$1,224,000	\$1,160,000	\$1,096,000	\$1,232,000	\$2,052,000	\$0	\$0	\$0	
Lease Revenue Bonds										
Old Town Trolley Expansion, 1993	\$1,280,283	\$1,282,173	\$1,282,413	\$1,281,288	\$1,279,128	\$1,280,903	\$1,281,353	\$1,280,438	\$1,283,350	
Bayside Trolley Extension/Police Facilities Refunding, 1994	\$7,153,663	\$6,432,328	\$6,434,555	\$6,426,680	\$7,912,895	\$7,911,283	\$7,904,630	\$7,886,733	\$7,879,104	
Stadium Lease Revenue Bonds, Series 1996A	\$0	\$5,810,184	\$5,770,158	\$5,771,178	\$5,769,098	\$5,772,138	\$5,770,388	\$5,768,728	\$5,771,703	
Convention Center Expansion, 1998			\$5,647,037	\$9,680,635	\$9,680,635	\$13,700,635	\$13,697,875	\$13,699,415	\$13,700,545	
Short Term Obligations - Equipment & Vehicle Financing	\$2,717,174	\$4,453,079	\$5,383,407	\$5,742,648	\$5,212,695	\$5,645,254	\$5,645,254	\$5,645,254	\$5,645,254	
Proposed Issuances										
Ballpark - 2001 (Estimate)	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$12,084,463	
Fire Stations - Phase I - 2002 (Estimate)	\$0	\$0	\$0	\$0	\$0	\$0	\$605,728	\$1,420,361	\$1,422,745	
New Main Library - 2003 (Estimate)	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	
TOTAL DEBT SERVICE	\$26,100,480	\$34,269,439	\$40,920,015	\$46,285,587	\$46,695,188	\$52,154,510	\$50,888,522	\$51,880,230	\$64,156,721	
Self Supporting Debt Service (Public Safety Communications, 1991) (supported by ad valorem tax)	\$2,368,875	\$2,365,118	\$2,361,405	\$2,358,260	\$2,360,540	\$2,352,463	\$2,355,335	\$2,348,785	\$2,333,936	
NET DIRECT DEBT SERVICE	\$23,731,605	\$31,904,322	\$38,558,610	\$43,927,327	\$44,334,648	\$49,802,047	\$48,533,187	\$49,531,445	\$61,822,785	
TOTAL GENERAL PURPOSE REVENUES(*)(**)	\$590,853,338	\$635,424,274	\$680,025,179	\$764,261,526	\$774,619,970	\$846,553,517	\$884,648,425	\$924,457,604	\$966,058,197	
NET DIRECT DEBT SERVICE/GENERAL PURPOSE REVENUES	4.0%	5.0%	5.7%	5.7%	5.7%	5.9%	5.5%	5.4%	6.4%	

\* Includes General Fund, plus general purpose revenues (sales tax, TOT, and Franchise Fees deposited in Special Revenue Funds).

\*\* Assumed 4.5% annual growth in general purpose revenues, FY 2003-2005.

REVENUE ANALYSIS - REVENUE PER CAPITA - ACTUAL DOLLARS  
CITY OF SAN DIEGO GENERAL FUND

	Fiscal Year				
	Budget 2002	2001	2000	1999	1998
REVENUES:					
Operating Revenues	\$665,115,000	\$675,100,000	\$618,580,000	\$551,003,000	\$515,241,000
Other Financing Sources	\$45,248,000	\$34,874,000	\$32,952,000	\$31,057,000	\$45,676,000
Total Revenues	\$710,363,000	\$709,974,000	\$651,532,000	\$582,060,000	\$560,917,000
					\$514,315,000

POPULATION (estimated) 1,267,000 1,250,700 1,277,168 1,254,281 1,224,848 1,197,077

\*Source: FY1997 - FY2001, Comprehensive Annual Financial Report (CAFR); FY2002, Budget adjusted to financial reporting basis for comparative purposes.

Operating Revenues per Capita \$525 \$540 \$484 \$439 \$421 \$396

Total Revenues per Capita for Rating Agency Comparison to Other Cities

	Fiscal Year				
	Budget 2002	2001	2000	1999	1998
San Diego	\$561	\$568	\$510	\$464	\$458
					\$430

Los Angeles \$744  
San Jose \$537  
Long Beach \$706  
Sacramento \$576  
Median - Cities with Population > 250,000 N/A

\*Source: 1999 Information from Moody's Investor Services

Definitions: Operating Revenues per Capita = Operating Revenues divided by Population  
Total Revenues per Capita = Operating Revenues plus Other Financing Sources divided by population.

**EXPENDITURE ANALYSIS - EXPENDITURES PER CAPITA - ACTUAL DOLLARS  
CITY OF SAN DIEGO GENERAL FUND**

	Fiscal Year				
	Budget 2002	2001	2000	1999	1997
<b>EXPENDITURES:</b>					
Operating Expenditures	\$704,208,000	\$653,293,000	\$604,408,000	\$553,609,000	\$521,079,000
Other Financing Uses	\$41,048,000	\$46,875,000	\$46,496,000	\$41,486,000	\$33,944,000
Total Expenditures	\$745,256,000	\$700,168,000	\$650,904,000	\$595,095,000	\$555,023,000
					\$521,054,000

POPULATION (estimated)      1,267,000      1,250,700      1,277,168      1,254,281      1,224,848      1,197,077

\*Source: FY1997 - FY2001, Comprehensive Annual Financial Report (CAFR); FY2002, Final Budget adjusted to financial reporting basis for comparative purposes.

Operating Expenditures per Capita      \$556      \$522      \$473      \$441      \$425      \$429

Note (1): Street Operations moved from General Fund to a Special Revenue Fund beginning with Fiscal Year 1998. General Fund transfers money to the Special Revenue Fund for Street Operations. This transfer are properly classified in the General Fund as Other Financing Uses.

**Total Expenditures per Capita for Rating Agency Comparison to Other Cities**

	Fiscal Year				
	Budget 2002	2001	2000	1999	1997
<b>San Diego</b>	\$588	\$560	\$510	\$474	\$453
					\$435

Los Angeles      \$761  
San Jose      \$526  
Long Beach      \$690  
Sacramento      \$546

Median - Cities with Population > 250,000      \$546

\*Source: 1999 Information from Moody's Investor Services

Definitions: Operating Expenditures per Capita = Operating Expenditures divided by Population.  
Total Expenditures per Capita = Operating Expenditures plus Other Financing Uses divided by population.

# EXHIBIT 8



Office of  
The City Attorney  
City of San Diego

MEMORANDUM

DATE: February 8, 2005

TO: Michael Aguirre, City Attorney

FROM: Sam Alatorre, Word Processing Operator

SUBJECT: City Council Rules Committee Discussion of 27 February 2002 re: Report from the Mayor's Blue Ribbon Committee on Budget and Finance: Partial Transcript

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VORTMANN: Good morning, I'm Dick VORTMANN and I'll be addressing the third key area that the committee investigated, and that's the retirement benefits and unfunded pension liabilities; and that includes both pension as well as retiree medical benefits. The basic conclusion that the committee reached is that the City is not paying from its current year budget the full cost incurred by its current year work force for their ultimate future pension and retiree health benefits. As a result of that, part of today's cost will be paid by future year tax payers; and that's a concern. Further, this nondiscretionary pension expense as a budget item has been steadily growing and will continue to grow in the future.

This next chart shows the pension expense as expressed as a percentage of the City's payroll base. And you can see that as a percentage it has been steadily increasing, clearly the pension expense has been increasing faster than the underlying payroll base. The budget line itself has been growing for the last five years at a 9 percent per year compounded rate. And that is a very troublesome trend for any business to see. And particularly when it is, as I said, as a non-discretionary item and in the '01 budget it was already at 68 million dollars, one of the larger line items.

Further, this expense expressed as a percentage of payroll is scheduled to continue to increase by a half percentage point per year. For example, by calculation by the time you get to FY 06, the current 68 million expense would be 106 million. The committee came up with two recommendations. First recommendation is to change the City's funding strategy to one that results in the City fully funding its future obligations that are being earned today and that would include both the pension benefits as well as the health benefits. Obviously, this would increase the expense for the current years, but will stop pushing the burden out to future years tax payers.

The second recommendation is to make sure that all on the City Council fully understand the mechanics, which are complicated, but the mechanics of the cost of pensions and retiree medical benefits. To ensure that we recommend that you obtain a current and comprehensive analysis of



the projected pension expenses and the revenue sources, which includes the current present value of retiree health benefits to determine the impact on future City finances. We believe this is particularly important to get this analysis and understanding before any further pension improvements are considered.

MAYOR: Ok, let's stop on item 3, Retirement Benefits and go to Byron.

WEAR: Can you quantify, if you can go back to the other slide there, if we were to have a strategy to keep it at the . . . you know, reduce the bleeding and keep it at 14.1, just hold the line here, we are still going to have a problem in later years, is that correct then?

VORTMANN: I do not believe you can hold it at 14.1.

WEAR: How do you translate it into dollars, how much more money, because would we have to put in to cover those costs.

VORTMANN: I believe, Ed, you have the number of, the annual short fall right now.

RYAN: Yeah, I believe that the net pension obligation runs somewhere around 6 to 8 million dollars a year, we are under funding.

WEAR: By how much?

RYAN: About 6 to 8 million a year.

VORTMANN: By 6 to 8 million a year, that you're under funding.

WEAR: That includes both general fund departments and enterprise fund departments. So, of the general fund that'll be progressed about 35, 40 percent of that.

RYAN: Oh, probably 60, 70.

WEAR: Towards the general fund?

RYAN: Yeah.

WEAR: So that's something that we need to look at as part of our budget deliberation.

RYAN: Yes.

WEAR: Ok, so for 6 or 8 million we can keep it at 14.1?

RYAN: Um, I don't know the answer to that, what the 6 to 8 million dollar does, is assure that you fund your current pension obligations, whether it changes the percentage or not, my guess, at the moment is that it will not stop the percentage from increasing because of the way the City agreed to fund the benefit given. It's under funding even the normal obligation because it intentionally back loaded the funding.

WEAR: Ok, I think this probably needs a whole hour unto itself and we need to get in the nitty gritty of what this is.

RYAN: Yes.

WEAR: It sounds like our own little version of the Social Security scandal here.

RYAN: It's not a scandal at all. The City intentionally entered into an agreement with the retirement fund to give a benefit about 5 or 6 or 7 years ago and came up with a non-standard way of funding it that the Retirement Board and the actuary accepted.

WEAR: What you are saying, it's going to have a general fund hit in later years.

RYAN: It was intentionally back loaded.

WEAR: Back loaded?

RYAN: Yes.

WEAR: Ok, well, sounds like someone is going to pick up the tab later. We are just affirming the ultimate . . .

VORTMANN: That's what the committee is telling you. And is also telling you that, when you went into it, you expected not to have enough pension obligation, but you are in fact having one because expectations didn't quite meet with the plan.

WEAR: Well, ok but we need to get into this at a later time.

MAYOR: I think Mr. Wear is right, this almost merits a whole discussion, you know, its kind of one of those things that the Retirement Board is in charge of, but we sort of put our head in the sand, but there is really, as I understand there's two issues here, separate. One issue is that we are not currently providing funding to make the pension fund whole, I guess for the lack of a better term. In other words, we should be putting 6 or 8 million dollars in a year or more to make it actuarially sound. And then, in addition to that, in addition to the under funding, we have this issue, that because of the way our system is structured, we are going continue to be increasing the percentage of our, as a percentage of our payroll base, going towards retirement. And even if we fully funded it, this would still be going up because there are more people drawing on the retirement system.

ANONYMOUS: [LEFT BLANK]

MAYOR: Ok, and the last question I have is, to what extent does the investments of the retirement fund offset the under funding? In other words, if the retirement fund, you know bought Qualcomm stocks two years ago and it went up 8,000 percent, does that solve the problem?

VORTMANN: [left blank]

MADAFFER: When I read this, Fred, before we started the meeting, I was extremely troubled to read that we are not paying the 6 to 8 million dollars for future pension. You know, here we are getting to go into the meet and confer process, you know we are in a tight budget year, I think all four unions are expecting pay increases for the employees. Healthcare is out of control around the country, and certainly in San Diego, anywhere from 20 to 50 percent and then we have this on top of it. And then of course you read the rest of the things, especially on the recommendations 4, 5, and 6 and we are in deep trouble here as a City, by virtue of the fact that we have done so very well from a fiscal health stand point but I read your definition of fiscal health and it is to maintain existing service levels when local and regional economic disruptions goes on and on and on. And that's a good definition, but I don't know if maintaining is what the public or the employees are going to be happy with. Certainly the public is not happy with it, we've done a lousy job fixing potholes, repairing sidewalks and everything else. I don't know about, if we can deal with the maintain thing. You know its one thing that we are going to get taken more money by the state probably next year and all the other problems we got. Now we add another 8 million dollars a year that we need to add in and that's growing. I'm just extremely troubled by that and I hope Mr. Manager when you come back with the budget that you present to the Council in May, that you address this issue and come up with a plan. This is definitely a huge hit.

MAYOR: I expecting the City Manager to come back hopefully at our next meeting which is in three weeks with the response on every one of these issues. . . . Anyway, this is exactly why this Blue Ribbon Committee is turned out to be a very helpful group because they say, look on your bonds you are doing great but on your pension plan you're not. And that's the kind of objective look we need.

[side B]

UNIDENTIFIED FEMALE: [left blank]

MAYOR: The plan would be that the full Council would do a workshop on the Blue Ribbon Committee's report in April. By then, the City Manager would hopefully have a response on some of these things. But to the extent that we take any one of these pieces and go into a greater depth like the pension issue, I think that would be something that this committee would look at along with the pension board. And maybe a representative group and committee just to focus on that issue. I don't see us addressing that in depth prior to the May budget. I see us only dealing it at this level, which is. . . superficial wouldn't, not mean to be an unkind word but, this requires a greater depth of understanding in our part before we took any action, I guess, and I don't see us being able to do that between now and the May budget process.

I think that concludes the questions on part 3.

# EXHIBIT 9

Rules Committee Meeting  
3-20-02

Mayor [M]- The record will reflect that all members of the committee are here except for councilmember Madaffer who was excused. He's back in Washington DC attempting to get money for us.

The first item on the agenda is the discussion regarding the City Manager's response to the recommendations made by the Mayor's Blue Ribbon Committee on budget and finance. We had a very thorough report presented by the Blue Ribbon Committee at our last meeting. It was based on almost a year's work on their part and we asked the City Manager to respond to each of the ten recommendations and I'm going to call on the City Manager to do that in just a second. I have taken it one step further and proposed a, I guess for lack of a better term a more detailed work plan that would sort of set out dates and I'll discuss that after the City Manager's made us the entire presentation, so to the extent that anybody thinks the dates are unrealistic or that my suggestions are incorrect, we'll debate that too. So, Mr. City Manager you're on.

City Manager [CM]- Yes, Honorable Mayor, members of the committee, we did not intend to do a comprehensive analysis of the respect recommendations by the Blue Ribbon Committee and we have a five page report incorporated in your packet of material here and what I thought I would do and just go through the Committee's recommendations and then verbally give some responses so in terms of my response, I don't want to in any way, shape or form have any indication that because we don't have a comprehensive analysis of the Blue Ribbon Committee's report we didn't think they were

important, they are very important. The Blue Ribbon Committee obviously spent a year, worked very hard on it, it's an excellent report. As I understood it, Mayor, the intent was for me to just come back in a couple weeks and briefly summarize my reaction and response to the recommendations, so that's what we intend to do.

M – Yeah, and you're doing exactly what we expected you to do. What my report then deals with is when do we deal in depth - my report. My half page memo goes into when do we deal in depth with each of these issues and how do we do that so I guess in effect it's a proposed work program and I'll give my rationale for the timing, you know what I have suggested after you go through your response. So no, you did exactly what we expected you to do.

CM – Okay, let's go ahead. First as you know in the report from the Blue Ribbon Committee, they had recommendations in these five areas – General Reserves, Retirement Benefits, Deferred Maintenance, Revenues and Expenditures, and Principles of Budgeting and Finance.

General Reserves – the Blue Ribbon Committee's recommendation – evaluate and procure what an adequate reserve level is for the City. The Committee recommends the reserved be changed to 7-10% and as you know I have, we have one of our principles at 3% for the general fund. – Next

Reserves obviously are an integral part of the City's financial health. The general reserves as was indicated in our report have more than doubled since 1997. Currently they are at \$30,000,000. – Next

What I would like to say about reserves, I did a study about ten years ago in Orange County and I did a study throughout the state of California as to the criteria that was used to determine reserves for general fund and I found a great deal of variance among the respective cities. Some cities and large cities in particular had reserves of 1% of their general fund. Some cities have reserves the average was probably 3% of their general fund of major cities. The criteria that you really should use are things like your revenue base, the stability of your revenue base, the variability of your revenue base, you need to really evaluate that revenue base, what kind of fluctuations do you have in it, do you have strong revenue base, a weak revenue base. What's your debt, what kind of debt do you have, what kind of potential liabilities do you have as a city, are they significant liabilities. Are you going to have reserves that would address the major catastrophe you might have in the city, are you going to have reserves that are going to address the kind of normal things that you would have or need for those reserves. Also what we did in this one city I was in, the last city is we actually identified a 3% general fund reserve and we put any money that was left over at the yearend into that reserve. Then if that reserve got greater than the 3% then we had a category or categories of how we would use those funds, such as deferred maintenance. So, any of the reserves that were above and beyond that percentage went to one time expenditures. So we said, okay, we'll have reserves, reserves on an annual basis, if they get greater than his amount we will then, we'll go to



the City Council, we'll have a recommended list of one-time expenditures that are used when we exceed that reserve amount. We haven't done that here, to be very candid.

When I got here 4-1/2 years ago the reserves were quite low, about 3,000,000 out of some 600,000,000 general fund, were now at, as you see at \$30,000,00. We pretty much put those reserves on hold, their not appropriated they can't be spent unless Mayor and City Council identify how they're going to be spent during the course of the year. But that's an approach that we used in another city that we might want to talk about. What the reserves ought to be. So, when you say 7-10%, I would say 7-10% why, what's the criteria, why should we have 7-10%, is that reasonable, is that the amount. So, I'll go back, I'll do an evaluation of a 7-10% versus 4, versus 5, or even versus more than that. There's some cities depending upon their financial health, and I'll give you an example. City in Orange County – Costa Mesa – is a small city of about 85,000-90,000 people and their general fund reserve are 40%. Now why are they 40%, because you have Southcoast Plaza sitting right there at Costa Mesa and it's a small city of 85,000 people and all the people from that region in Orange County go shop at Southcoast Plaza so their money frankly, I don't want to say it's rolling in but they have a lot of money so actually have about 40% of their general fund reserved so they can take those reserves and they can put them into deferred maintenance, they can deal with a lot of other issues. Most cities, though, in California especially since early 90's, their reserves will be between 1% and 5% and I'll do a little survey of that when we come back and deal with this in a comprehensive way.



M – Maybe it would be helpful for me to stop and point out on my memo I’m suggesting with regard to Blue Ribbon Committee recommendation 1, really that we adopt the first sentence which says “to evaluate and determine whether an adequate level for the City,” the second sentence which recommends 7-10%, that’s, I’m not proposing we adopt that, I’m proposing that that be considered in your report. Now I specifically said proposal to Rules committee by July 31 and this was sort of an act of great sensitivity. I realize that the financial management people in the Auditors Office are going to be very busy over the next three months working with our budget and asking them to come back right in the middle of the height of their heaviest work season really wasn’t either fair or maybe even in the best interest of a thorough report so I picked the earliest date I thought was reasonable which was July 31, that means you actually have a day off , perhaps July 4<sup>th</sup> off and that in July you’d come back and do this report and that this committee would consider it during August. While this is an important one, this is probably an easier one to prepare than some of the other ones that are suggested ...

CM – Correct

M – so that was my thought on the first one.

Unknown – Mr. Mayor, on the first

M- Yep,

Unknown speaker [US] – on the reference that CM just made, can I ask you a quick question. You used Southcoast Plaza, is a mall I'm familiar with in Orange County. Did you find out, you said the money is rolling in,

CM - For that city and that city alone.

US – right, so but it doesn't matter on our farm whether the money is rolling in or not, we'll only get back 13% of all the sales taxes, so could you tell me how much percent of their sales tax they get back from the state?

CM – they would be about the same, about 13%, it's just that what you have is you have a city of 85,000 people and you have a region of probably 700,000-800,000 people that shop at that one area and it's the biggest shopping plaza, at one time it was one of the biggest shopping plazas in the country.

US, - right, thank you

CM – And frankly, now I don't want to divert, but I will for just a second. And that is one of the reasons at the state level there ought to be a real review of how cities are financed and the state legislature ought to evaluate that and come up with a financing program that's at least equitable. I think the way we're financed today is not an equitable way. It ought to be considered for changes and what it's done is, we call it the planning and development and has gone aside to some extent, gotten a lower priority as compared to

trying to insure that you're financially stable and capable so a lot of the cities have gone for big box, gone for car dealers, that they would not have done in the past had the financial structure been different at the state level. So that's a whole other subject but its an important subject.

M- I'm going to call on Byron here in just a second. I think probably the more meaningful way to do this is, as we go through each of those six subjects areas to stop and let me just say to Mr. Quaver or any member of the Blue Ribbon Committee, if you feel you want to pop, if you feel the need to pop up on any of those, just come up to the microphone and indicate that any of the members of the Blue Ribbon Committee that are here, if you want to comment you're feel to do so as we go item by item. We do have one public speaker but I'll take the public speaker at the end of the presentation. Mr. Wear.

Bryan Wear [BW] – Yeah, I was going to say Deputy Mayor Stevens will be \_\_\_\_\_ cover both Mission Valley and Del Mar, even that small city would have an abnormal amount of sales tax, so I think that's what the Costa Mesa example is. Of the \$30,000,000 in reserves, I didn't realize we were that high. You must have included some other reserve dollars in that.

M- Yes, if you look in the report what you have is \$19.5M in general fund reserves, \$6.9M of convention center reserves, \$2.1M of MTBD trolley reserves and a\$2.M GASBI 31 reserve. So, yes the reserves are in addition to what we normally refer to as general fund reserves.

BW – Thank you

M – so that's the \$30.5M

M– Mr. Wear brings an important point here in this report that I'm suggesting that the manager bring back by July 31. We need to a recommendation on general fund reserves, and a recommendation all reserves because the area that we know we're the most vulnerable on is the general fund revenues and so it might be a different percentage for the general fund reserve than for all other reserves because theoretically if we had some problem in the water or sewer department we could raise rates. It's not like it couldn't be done on an emergency basis.

M – and we should summarize those reserves, some of them have restricted purposes and are mandated by laws and/or mandated by the Bonds that you sell identify all those types of reserves too. Any other questions?

CM – anything else on #1? Okay, let's go on to recommendations 2 and 3. Retirement benefits and unfunded pension liabilities. The Blue Ribbon Committee's recommendation – change the City's funding strategy, one that results in the City fully funding it's future obligations earned today which includes the pension benefits as well as health benefits. Obtain a current comprehensive analysis of the projected pension expenses and revenue sources including current present value of retired health benefits, determine future. Next.

Unfunded retirement health benefits are a liability. The committee recommended that we look at that and that it would cost approximately \$6-8M per year to address that unfunded liability and the amount of unfunded pension expenses continues to grow approximately 9% per year. – Next

What I would recommend on the retirement system is that we actually have a workshop at a subsequent date Mayor and it would be up to you in terms of the process if you wanted to have that at Rules and then the full City Council, but there should be some time when the full City Council has a workshop on the retirement system. It is rather complicated as to how we're funded, what's the status of the funding, what's the process and then an evaluation of the stability of the retirement system so I would request that I be directed along with requesting the retirement officer, Larry Grissom, to develop a report, come back and have a workshop at some subsequent time on the overall system. So I don't have specific recommendations regarding unfunded liabilities at this point in time and/or status of the retirement system but I would say that we did a workshop at a subsequent date. Just as a side, looking today because you know we don't have a lot to do around here so this morning at 7:00 o'clock I was reading a retirement research committee report, it's a bit outdated, it's a 2000 comparative study of major public retirement systems in the country that evaluates 85 retirement systems that are public systems in California. They only evaluated the CALPERS which is the State Public Employee Retirement System but they talk about transient employer contributions, and employee contributions and funding levels and benefits. I'm going to suggest to Larry Grissom that he, and prior to that workshop, get whatever's most recent comparative

information about public retirement systems to kind of serve as a backdrop when we evaluate our system so we don't evaluate our system totally in isolation. We evaluate it in the specter, if you will, of public sector retirement systems, how it's funded, is it adequately funded, what are some of the approaches and methodologies that should be used, so Mr. Mayor, my response is we ought to have a workshop in a comprehensive way at some subsequent date.

M- On my memo recommendation #2 says that we refer the issue initially to the Retirement Board and ask them to give use a report by June 30 and so, I guess there is an issue here of how best to do this. My concern is that I wasn't so sure it was appropriate for this committee to go off on it's own, the Retirement Board has the legal responsibility under the Charter to oversee the operation of the retirement system and so my recollection is we only indirectly control what they do

CM – that is true

M – so we, we come directly here with a workshop, it least seem to violate sort of protocol if not losing the lack of the Retirement Board thoughts and input on this. I think what I know discovered based on the Blue Ribbon Committee point, I mean what the Blue Ribbon Committee pointed out is, on this issue, was something that a lot of this council wasn't even aware of. And it turns out maybe I think this is a fair statement, that there was perhaps some decisions made by prior City Councils that deliberately under-funded the pension system in order to cover their budget deficits in the 90s. I don't think

it is like a crisis situation but it's a serious situation and we need to address it, but I thought that we really ought to ask the Retirement Board to respond first and then have the City Manager and the committee or the council have the workshop. Let me ask Mr. Vortman if he sees any problem, if he thinks that, it seems to me that we ought to go to the Retirement Board first.

Vortman – I think that would work very well, my only comment would be to urge speed in this process. I would urge the Council to make sure they fully understand what the City manager has very appropriately said is a very complex situation but that you fully understand what the current situation is before you have to deal with any possible improvements in benefits.

M – Yeah, I understand, your point is before we even approve a budget this year, we ought to address this issue and actually we have in part of our meet and confer process but the “fixing the problem” is not really being addressed and the earliest one on the list, the June 30<sup>th</sup> date, but the problem is addressing this prior to negotiating salary increases for city employees is a difficult timetables I guess,

CM - to be very candid, we are in the middle of negotiations, all of our contracts expire on June 30 and I would agree that the Mayor and City Council ought to have an opportunity to review the retirement system before there's considerations of enhancements but at the same time we're in the middle of negotiations, we need to make sure we meet and confer in good faith and that we not interrupt that process so we can do

it in terms of the evaluation but you need to make sure that we meet and confer in good faith with our unions during the course of that discussion. And when you look at the retirement system you have short term issues and long term issues and I would not say that there was not urgency in reviewing the system, there certainly is and we should look at it and I would concur, Mayor, that the Board as you know has a fiduciary responsibility, the Board has a degree of independence in managing, if you will, the retirement system. They do so in part by certain federal and state laws so there is a degree and there's some arm's length between the responsibility between the Council and the Board.

I think Madam City Attorney, before we, we kind of need to know what that inter-relationship is. I always feel that when there was a fight between the City council and the Retirement Board in the 80s over who's in charge, and ultimately the City Attorney's opinion was at least on investment decisions the Retirement Board was in charge and this Council cannot dictate investment decisions to the Retirement Board for example, but on policies and issues being fully funded, I'm assuming that this Council then has the not only the right but the obligation to set those and makes those kind of policy decisions.

City Attorney - In many of those policy decisions, we'll need to and must come back to Council but the actually funding as you have already said is within the Retirement Board and many times the Retirement Board will take exception to the City Attorney's position on what ultimately needs to come before the Council for approval so we can certainly look into that.



M – What we have is a situation which is probably healthy in which is the Retirement Board has it's own attorney and can disagree with the City Attorney, it has. So, even though I agree with Mr. Vortman, there is some sense, there is a need for us to understand that there has been historically an under-funding of the retirement system and this year in the meet and confer process we need to be aware of that when we negotiate. Nevertheless we need time to address it's a complicated issue and we need to have the Retirement Board tell us first what they think.

CM – right I would concur. Byron.

BW – Yeah, your honor, I having looked at this recently in the last week and the information I've been given is I wasn't, I'm not as concerned as I was when this recommendation popped out 2-3 weeks ago. I think we need to spend some time on dealing with it from a long term standpoint, it's not a crisis, it's something that can be handled in June or July I don't think we have to do it right away. I think your schedule is find.

M – Yeah, the idea would be that we have this recommendation in June and perhaps we discuss it in July or perhaps the City Manager still needs more time to analyze what their recommendation is.

CM – We're doing 10 times better than social security situation so ...

M – yeah, I'm not sure that social security is such a good yardstick to follow, but ... and you'll recall that the numbers here in the report show that our funding is somewhere between in excess of 90% of the needs of the system but 100% would be the ideal way to operate.

CM – let's go on to #3, recommendations 4, 5, and 6 - general deferred maintenance, unfunded procurement. The Blue Ribbon Committee recommended that the Manager establish a process that all deferred maintenance and unfunded procurement information is developed, aggravated, consistent, complete and non-duplicative, rated for priority and is available for budgetary decisions. – Next

# EXHIBIT 10

Office of  
The City Attorney  
City of San Diego

MEMORANDUM

**DATE:** January 13, 2005  
**TO:** Michael J. Aguirre, City Attorney  
**FROM:** Dan Andrews, City Attorney Investigator  
**SUBJECT:** Rules Committee Meetings on 2-27-02 and 3-20-02

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**CONFIDENTIAL ATTORNEY WORK PRODUCT**

On 1-13-05 a review was conducted of the tape recordings of the Rules Committee Meetings on February 27, 2002, and March 20, 2002. Only the portions of the tapes pertaining to the Retirement System were reviewed. The following is a summary from the discussions:

**February 27, 2002**

This meeting was attended by all of the Blue Ribbon Committee Members, Mayor Dick Murphy, several City Council Persons, Ed Ryan, and others.

Blue Ribbon Committee Member Dick Vortman presented the section of the Blue Ribbon Committee Report pertaining to the retirement benefits and unfunded pension liabilities. They concluded that the City was not paying, from its current year budget, the full benefit cost incurred by its current year workforce. He noted that this was a concern. He stated that the non-discretionary pension expense as a budget item has been steadily growing and would continue to grow. He provided information on pension expense expressed as a percentage of the City's payroll base. This has also been steadily increasing. The budget line itself has grown at 9% compounded rate. Currently this is \$68 million. He noted that this was very troublesome, as it was increasing by ½% per year.

He provided two recommendations: To change the City's funding strategy, and to fully fund the pension fund and increased benefits; and, to make sure all on the City Council fully understand the cost of retirement benefits, and that the present value of retiree health benefits be obtained.

Ed Ryan provided that annual liability shortfall was \$6 million to \$8 million per year. He noted that the system was intentionally "back-loading the funding. Ryan urged the Council to try and fix this.

Byron Ware commented that it sounded, "Like our own little version of a Social Security scandal." Ryan noted that the City intentionally under-funded the system with a "non-standard" method of funding that the SDCERS Board and actuary accepted. Ware stated, "It looks like someone is going to pick up the tab later." Ryan agreed, noting that expectations did not meet with the plan (presumably high investment returns).

Mayor Murphy noted that this issue merited its own lengthy discussion. He stated that they previously let the SDCERS Board handle the issue while they (the Council) put their "heads in the sand."

Vortman stated that even with the record stock market boom, the City is in arrears and this is of "grave concern." Most pension plans are flush.

Jim Madaffer stated that he was extremely troubled by this report. He stated, "We are in deep trouble here as a City...as we are not meeting the definition of fiscal health provided by the Blue Ribbon Committee."

Mayor Murphy stated that he expected the City Manager to return in three weeks with his comments on the Blue Ribbon Report. It was suggested that this issue be discussed with the entire Council; and, that perhaps a workshop be conducted on the Blue Ribbon Committee Report in April.

There was no discussion during this meeting of funding ratios expressed as a percentage of full funding.

There were no additional discussions on this issue.

### **March 20, 2002**

This meeting was attended by several City Council Persons, Mayor Dick Murphy, City Manager Mike Uberuaga, several members of the Blue Ribbon Committee including Dick Vortman, and others.

City Manager Mike Uberuaga was tasked to provide a response to the Blue Ribbon Committee Report provided at the Rules Committee Meeting on 2-27-02. He was to provide his comments on the report with some recommendations.

Uberuaga began his discussion with the caveat that his comments were by no means a comprehensive analysis. He submitted a five page report summarizing his thoughts. Mayor Murphy tasked Uberuaga to return on 7-31-02 with a comprehensive response to the Blue Ribbon Committee Report.

Uberuaga discussed the portion of the Blue Ribbon Committee Report pertaining to the Unfunded Pension Liability and Benefits. He noted that the Blue Ribbon Committee suggested

that the Pension Fund be immediately fully funded and that the City conduct a comprehensive study as to the future costs of the increased benefits.

Uberuaga noted that the unfunded pension liability is growing at 9% per year. He noted that the pension funding issue is a complicated one that requires extensive study in order for council members to understand the system enough to make sound recommendations. He suggested that the City Council participate in a workshop. In addition he recommended that Larry Grissom obtain comprehensive information on other public sector retirement systems so that the Council would be able to compare the City of San Diego's system with other similar systems.

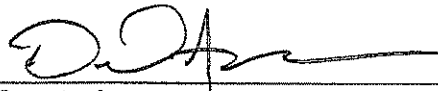
Mayor Murphy interjected that he felt it was more appropriate for the SDCERS Board to evaluate the Blue Ribbon Report and to provide a response prior to the Council attending a workshop. He recommended that the Board provide a response to Council by 6-30-02. he noted that the Board by Charter controls the retirement system. He felt that it may be inappropriate for Council to involve themselves too deeply in the issues of retirement system funding. He stated that the workshop may violate "protocol." He noted that it was a prior City Council that under funded the system to cover their deficit, and that it is a serious, but not crisis situation.

Dick Vortman was asked for his comments on the Mayor's suggestions. Vortman stated that he agreed with the Mayor, however he "urged speed" in resolving this issue. He suggested that decisions be made prior to the current fiscal year's budget being approved.

Mayor Murphy responded that it would be difficult to make changes prior to budget approval. He noted that they were currently involved in meet and confer sessions with the Unions and he felt that addressing this issue at this time may compromise these sessions. Murphy requested the City Attorney to provide guidance on the relationship between the SDCERS Board and Council in terms of making funding decisions.

Byron Ware interjected that he was no longer as concerned about the funding as he was during the February 27<sup>th</sup> meeting. He stated that the funding was not a crisis and that the July schedule was fine. Mayor Murphy noted that they may even need more time to properly address the issue. He stated that he was comfortable that it was not a crisis issue as the report showed funding in excess of 90%.

There were no additional comments or discussion.



Dan Andrews  
City Attorney Investigator

:da

cc: Robert Abel, Principal City Attorney Investigator  
Christopher S. Morris, Head Deputy City Attorney



EXHIBIT 11

## CLOSED SESSION REPORT [X] CITY OF SAN DIEGO [ ] OTHER (See below)

TITLE Labor negotiations - meet and confer  
labor negotiations HDCA Heap

DATE OF CLOSED SESSION: 3/18, 2002

☐ REAL PROPERTY NEGOTIATIONS G.C. § 54956.8

☐ Ongoing/Status Report

☐ Final Approval of Agreement (D)

Substance of Agreement: \_\_\_\_\_

☐ Final approval dependent on other party

☐ LITIGATION G.C. § 54956.9

☐ (a) Pending ☐ (b)(1) Significant Exposure ☐ (b)(2) Authorizing Session ☐ (c) Initiating

☐ Defend Litigation (D)

☐ Status Report

☐ Seek Appellate Review (D)

☐ Refrain from Seeking Appellate Review (D)

☐ Amicus Participation

☐ Other (see below)

☐ Settlement Offer To Be Conveyed

☐ Acceptance of Signed Settlement Offer (D)

☐ Initiate Litigation or Intervene (D)

☐ Contingent Acceptance of Signed Offer

☐ Non-Disclosure of Litigation Recommended (check if yes): ☐ See Report

☐ Interfere with service of process ☐ Impair ability to settle

☐ CLAIMS DISPOSITION G.C. § 54956.95

☐ Offer Made

☐ Offer Accepted

☐ See Report

☐ DECISION ON EMPLOYMENT STATUS G.C. § 54957

☐ Appoint (D)

☐ Employ (D)

☐ Accept Resignation (D)

☐ Discipline (D)

☐ Dismissal or Nonrenewal (disclose after exhaustion of administrative remedies) ☐ Performance Evaluation

Title: \_\_\_\_\_

Change in Compensation: \_\_\_\_\_

ATTENDEES:

[X] City Mgr [X] Asst City Mgr [X] Sr Dep City Mgr (Loveland)

[X] City Atty [X] Exec Asst City Atty [ ] Asst City Atty (Girard)

[X] City Auditor

[X] Other Bruce Herring, Terri Webster, Pat Frazier,

[X] LABOR NEGOTIATIONS G.C. § 54957.6

[X] Ongoing/Status Report

☐ Final Approval of Agreement (D) Other Party to Negotiation: \_\_\_\_\_

Item Approved: \_\_\_\_\_

☐ PUBLIC SECURITY THREAT G.C. § 54957

Rich Snapper, Elmer Heap, Sharon Marhsall, Dan Kelley,

Bill McGhee, Cathv Lexin, Val Van deweghe

[X] VOTE

☐ NO VOTE NECESSARY

Economic proposal:

Name	Yea	No	Absent
District 1	X		
District 2 S	X		
District 3	X		
District 4	X		
District 5	X		
District 6	X		
District 7			X
District 8 M	X		
Mayor	X		
Voting Tally	8	0	1

COMMENTS: 1) Health Plan: staff recommendation (\$10 office, \$5 generic/

\$10 Brand Rx, \$50 ER visit) 8-0-1; 2) Retiree Health: staff recommendation (same

as above) 8-0-1; 3) Economic Proposal: staff recommendation: \_\_\_\_\_

a) POA/Fire/Lifeguards - FY03 1% mid-year + \$100 flex each year, 2 yr agree, \_\_\_\_\_

2% FY04 mid-year; b) MEA/127 - FY03-1% mid year, + \$100 flex, 2 yr agree, \_\_\_\_\_

2% FY04 mid-year + willingness to discuss retirement + trigger if we lose VIL fees. \_\_\_\_\_

APPROVED: \_\_\_\_\_

NOTE: (D) DISCLOSE FOLLOWING CLOSED SESSION

NOT A PUBLIC RECORD

until the information in this box is completed,  
 signed by an authorized representative of the  
 City Attorney's Office and stamped in the space below

Date Litigation Concluded: \_\_\_\_\_, 200 \_\_\_\_\_

By: \_\_\_\_\_

Title: \_\_\_\_\_

(STAMP HERE)



**CITY OF SAN DIEGO  
M E M O R A N D U M**

DATE: March 15, 2002  
TO: Honorable Mayor and City Council  
FROM: Daniel E. Kelley, Labor Relations Manager  
SUBJECT: Closed Session Meet and Confer Materials for March 18, 2002

---

Attached is the Closed Session meet and confer Powerpoint outline for the extended 9 a.m. to 12 p.m. meeting on Monday, March 18, 2002.

  
Daniel E. Kelley

---

Attachment

Check

CPI

Breakdown

OF

Salaries

OF

City of San Diego

Employees  $\$$

Include in our  
proposal some language  
RE: State Take away  
potential  $\$$  Reopener -

Salary Increases  
amended  $\$$

## Meet & Confer 2002

Closed Session

March 18, 2002

## Meet & Confer 2002

### AGENDA

1. Overview
2. Health Insurance Renewals (Action)
3. Economic Environment & Cost Scenarios (Info)
4. Status of Negotiations (Info)
5. City's Initial Economic Proposals (Action)
6. Retirement System/Meet & Confer (Info)
6. Next Steps



## Meet & Confer 2002

### OVERVIEW

- ♦ Union and Management Priorities
- ♦ Unions' Initial Salary Proposals FY03
- ♦ Cost Scenarios
- ♦ Management Team Recommendation For Initial Economic Proposals
- ♦ Gap Between Initial Salary Proposals

3



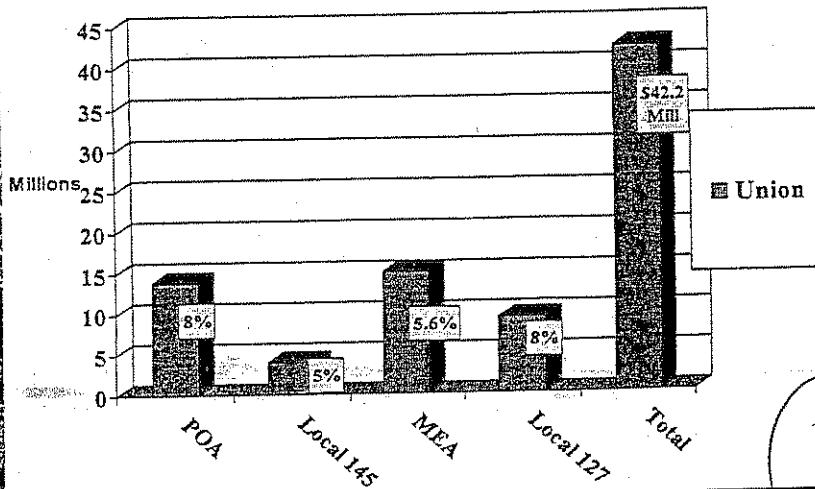
## Meet & Confer 2002

### Union and Management Priorities

- ♦ Unions' Priorities will be
  - Salary
  - Flex Allotment Increases (for Health Costs)
  - Retirement Formula for General Members
    - 2.5% at age 55
- ♦ Management Priorities will be
  - Reaching Agreement/Labor Accord
  - Evaluate and plan for long term cost implications
  - Ensure Management Rights are protected

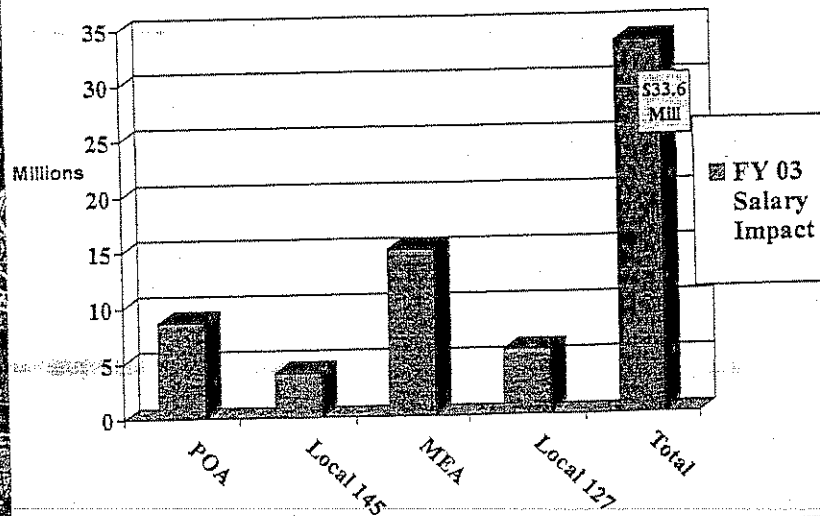
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## FY 03 Total Cost of Initial Union Salary Proposals



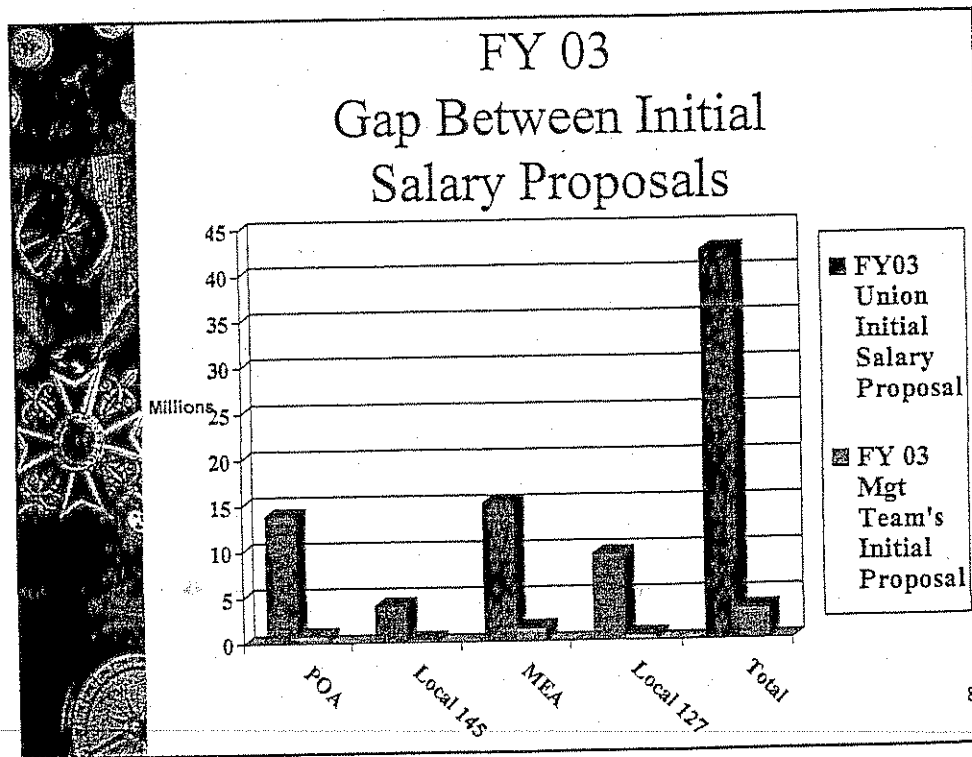
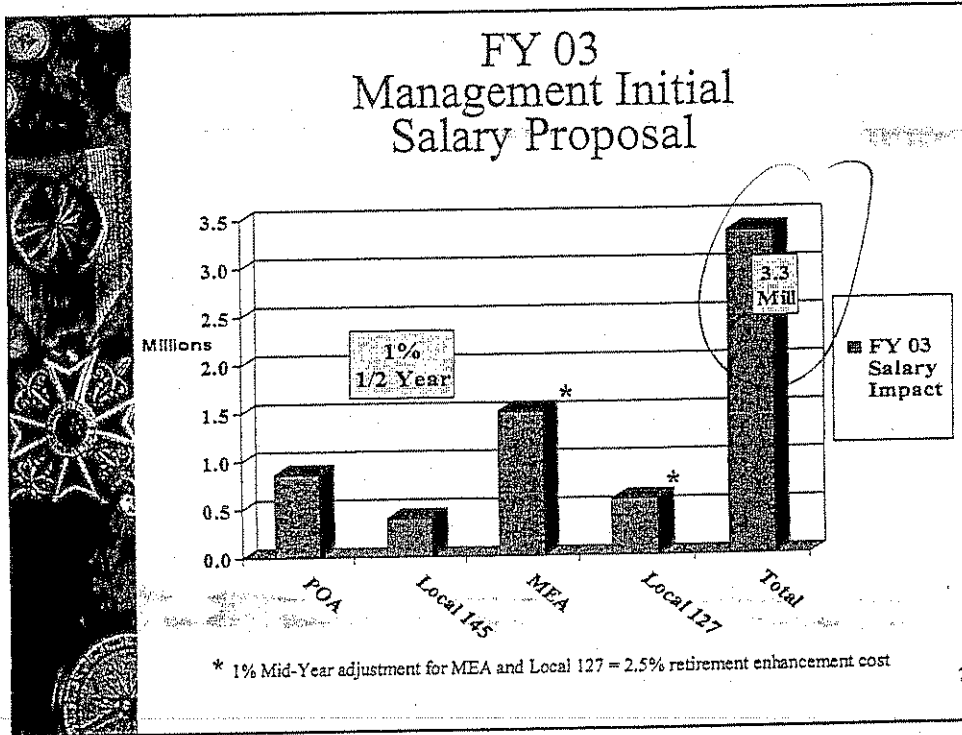
5

## FY 03 Total Cost of 5% Salary Adjustment



6

8,48  
 = 3-50  
 11,98





## Meet & Confer 2002

### AGENDA

1. Overview
2. *Health Insurance Renewals* (Action)
3. Economic Environment & Cost Scenarios (Info)
4. Status of Negotiations (Info)
5. City's Initial Economic Proposals (Action)
6. Retirement System/Meet & Confer (Info)
6. Next Steps

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## Meet & Confer 2002

### Health Insurance Renewals

- City Selects Health Plans and offers to both Active and Retired Employees
- Unions also offer Health Plans to both Active and Retired Employees
- Active Employees pay from Flex Allotment (\$4,375/\$7,197) and/or from payroll deductions
- Retired Employees are reimbursed for health insurance for retiree-only up to an amount established by City in Municipal Code (up to highest cost City HMO = \$3,694)

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## Meet & Confer 2002

### Health Insurance Renewals

- Dramatic changes are occurring in the health insurance environment, including:
  1. A growing backlash against HMO's, shifting enrollment toward PPO's
  2. Rapidly increasing health care costs, likely doubling in the next 5 years
  3. Employer cost increases exceeding budgets and ability to pay
  4. Aggressive plan design changes and cost sharing to offset increases and create incentives for employees to control costs

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## Meet & Confer 2002

### Health Insurance Renewals

- Last month, presented preliminary results of health proposals; premium increases ranging from 16% to 52% at current benefit levels
- Subsequently, have negotiated "best prices" and plan design options with PacifiCare and Kaiser to mitigate cost impacts
- Have terminated further discussions with Blue Cross; small rate difference not worth disruption to employees/retirees

12

## Meet & Confer 2002

### Health Insurance Renewals - Active Employees PacifiCare HMO - Annual Cost

	Enrollment	FY 02 Cost	FY 03 Cost Option 1	Premium Increase to Employees	
Employee	912	\$2,386	\$2,801	\$415	17.4%
EE + 1	267	\$4,773	\$5,602	\$829	17.4%
EE + 2	429	\$7,159	\$8,402	\$1,243	17.4%

- \$10 office visit; \$5 generic/\$10 brand Rx; \$50 ER
  - Plan design change to \$10 office co-payment saves 2.2% on renewal:
- Employee Only = \$ 53 annually  
 Employee + 1 = \$105 annually  
 Employee + 2 = \$158 annually  
 (Current Flex: Employees = \$4375 Unclass/Unrep = \$7197)

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## Meet & Confer 2002

### Health Insurance Renewals - Active Employees PacifiCare PPO - Annual Cost

	Enrollment	FY 02 Cost	FY 03 Cost	Premium Increase to Employees	
Employee	133	\$3,605	\$5,170	\$1,565	43.5%
EE + 1	36	\$7,210	\$10,340	\$3,130	43.5%
EE + 2	23	\$10,814	\$15,510	\$4,696	43.5%

- \$250 deductible; 90% in network/80% out-of-network; \$10 generic/\$20 brand Rx
- No plan design changes
  - (Current Flex: Employees = \$4375 Unclass/Unrep = \$7197)

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## Meet & Confer 2002

### Health Insurance Renewals - Active Employees

#### Kaiser Option 1 - Annual Cost

	Enrollment	FY 02 Cost	FY 03 Cost Option 1	Premium Increase to Employees	
Employee	1,683	\$2,015	\$2,205	\$190	9.4%
EE + 1	838	\$4,029	\$4,409	\$380	9.4%
EE + 2	1,172	\$6,043	\$6,613	\$570	9.4%

- \$5 office co-payment; \$5 generic/\$10 brand Rx; \$35 ER
- Plan design change: Adding \$5 office co-payment, increasing brand Rx to \$10, and \$35 ER co-payment saves 7.3% on renewal:

Employee Only = \$145 annually

Employee +1 = \$291 annually

Employee +2 = \$437 annually

(Current Flex: Employees = \$4375 Unclass/Unrep = \$7197)

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## Meet & Confer 2002

### Health Insurance Renewals - Active Employees

#### Kaiser Option 2 - Annual Cost

	Enrollment	FY 02 Cost	FY 03 Cost Option 2	Premium Increase to Employees	
Employee	1,683	\$2,015	\$2,120	\$105	5.2%
EE + 1	838	\$4,029	\$4,240	\$211	5.2%
EE + 2	1,172	\$6,043	\$6,359	316	5.2%

- \$10 office co-payment; \$5 generic/\$10 brand Rx; \$50 ER
- Plan design changes: Adding \$10 office co-payment; increasing brand Rx to \$10; and \$50 ER co-payment; saves 11.5% on renewal:

Employee Only = \$230 annually

Employee +1 = \$460 annually

Employee +2 = \$691 annually

(Current Flex: Employees = \$4375 Unclass/Unrep = \$7197)

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## Meet & Confer 2002

### Action

#### Recommendations For Active Employee Plans:

1. Authorize renewals at premiums shown earlier with PacifiCare and Kaiser
2. Authorize modified co-pays by employees that standardize plan designs for PacifiCare (Option 1) and Kaiser (Option 2) HMO plans in line with industry standard:

\$10 office visit co-pays by employees

\$5 generic/\$10 brand Rx with formulary

\$50 emergency room co-payment

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## Meet & Confer 2002

### Health Insurance Impacts on Meet & Confer

Annual health premium cost increases to employees:

	Emp Only	Emp +1	Emp +2	Weighted Average
PacifiCare - HMO	\$415	\$829	\$1,243	\$ 705
PacifiCare - PPO	\$1,565	\$3,130	\$4,696	\$2,234
Kaiser - Option #2	\$105	\$211	\$316	\$196
Total	\$ 280	\$ 448	\$623	\$ 416

Annual cost to the City for Flex Increases for FY2003\*

	+\$100	+\$200	+300	+400	+500
G.F.	\$ 703,000	\$1,406,000	\$2,109,000	\$2,812,000	\$3,515,000
Other	\$ 395,800	\$ 791,600	\$1,187,400	\$1,583,200	\$1,979,000
Total	\$1,098,800	\$2,197,600	\$3,296,400	\$4,395,200	\$5,494,000

\*(Flex Value recommendations will be part of economic package)

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## Meet & Confer 2002

### Retiree Health Summary

#### FY 03 Retiree Health Insurance Renewals

	Non-Medicare	%	Medicare	%
PacifiCare HMO	\$4,400*	3.2%	\$1,517*	28.5%
PacifiCare PPO	\$5,870	6.2%	\$5,529	43.8%
Kaiser	\$3,810	10.5%	\$1,480	42.0%

\*The Municipal Code generally establishes the reimbursement rate up to the highest paid retiree HMO rate = \$4,400/\$1,517

Rates reflect recommended active plan design changes

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## Meet & Confer 2002

### Retiree Health Insurance: Impacts on Meet & Confer

1. Muni Code sets maximum reimbursement tied to City's PacifiCare HMO plan
  - For FY03: = \$1517/yr (Medicare)  
= \$4400/yr (non-Medicare)
2. Currently, MOU's prohibit diminishing HMO plan design without Union agreement
  - FY03 Proposal is to increase office visit co-pay from \$5 to \$10; brand Rx to \$10; ER \$50 co-pay (viewed as diminishments)
  - Requires Union's agreement in current MOU

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## Meet & Confer 2002

### Retiree Health Insurance: Impacts on Meet & Confer

3. Police/Fire Unions sponsor "richer" PPO plans, cost more than City's HMO's
4. Police/Fire Retirees who purchase Union plans are capped by City's rates per the Muni Code
5. Consequently, Unions oppose City cost containment measures (diminishments) which reduce rates

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## Meet & Confer 2002 Action

### Recommendations for Retiree Health:

1. Authorize renewals with PacifiCare and Kaiser
2. Authorize modified co-pays by employees that standardize plan designs for PacifiCare and Kaiser HMO plans and are in line with industry standard:
  - ♦ \$10 office visit co-pay by employees
  - ♦ \$5 generic/\$10 brand Rx with formulary
  - ♦ \$50 emergency room co-payment

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## Meet & Confer 2002

Recommendations already authorized:

3. Direct Management Team to negotiate amendment to Muni Code and MOU's standardizing retiree "health benefit" reimbursement beginning FY03 for all eligible retirees equivalent of PacifiCare PPO:

From PacifiCare HMO	To PacifiCare PPO	
\$4400/year	\$5870/year	Non-Medicare
\$1517/year	\$5529/year	Medicare

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## Meet & Confer 2002

Recommendations already authorized:

4. Negotiate an agreed-to index, but no more than City's PPO Plan rates
5. Negotiate a re-opener trigger should a major shift occur in enrollment toward PPO's
6. Condition this benefit on the creation of an IRS Section 115 Health Trust within CERS to be funded from earnings annually (115 Health Trust not as limiting as current 401(h) Trust)
7. Further condition upon support from Unions with CERS to fund IRS Section 115 Health Trust from CERS earnings

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## Meet & Confer 2002

Retiree Health Insurance:  
Annual Cost Funded by 401(h) Trust

FY02		FY03 Current Co-Pays		FY03 Proposed Higher Co-Pays by Retirees	
	Current HMO Cap*	Current HMO Cap*	Proposed PPO Cap**	Current HMO Cap*	Proposed PPO Cap**
TOTAL	\$ 9.0 m	\$11.7 m	\$11.8 m	\$11.0 m	\$11.0 m
Increase		\$ 2.7	\$ 2.8 m	\$ 2.0 m	\$ 2.0 m

\*FY03 HMO Based Cap = \$1517 (Medicare), \$4400 (Non-Medicare)

\*\*FY03 PPO Based Cap = \$5529 (Medicare), \$5870 (Non-Medicare) <sup>25</sup>

## Meet & Confer 2002

Retiree Health Insurance  
401(h) Health Insurance Trust

6/30/01 Balance	=	\$26.755 m
FY01 Earnings Added	=	\$14.317 m
FY02 Costs	=	<u>-\$ 9.012 m</u>
Est. 6/30/02 Balance	=	\$32.060 m
FY02 Earnings Added (Est.)	=	+\$0
Est. FY03 Costs	=	<u>\$11.071 m</u>
		\$ 20.989 m
FY03 Earnings	=	?

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## Meet & Confer 2002

### AGENDA

1. Overview
2. Health Insurance Renewals (Action)
3. *Economic Environment & Cost Scenarios (Info)*
4. Status of Negotiations (Info)
5. City's Initial Economic Proposals (Action)
6. Retirement System/Meet & Confer (Info)
6. Next Steps

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## Meet & Confer 2002

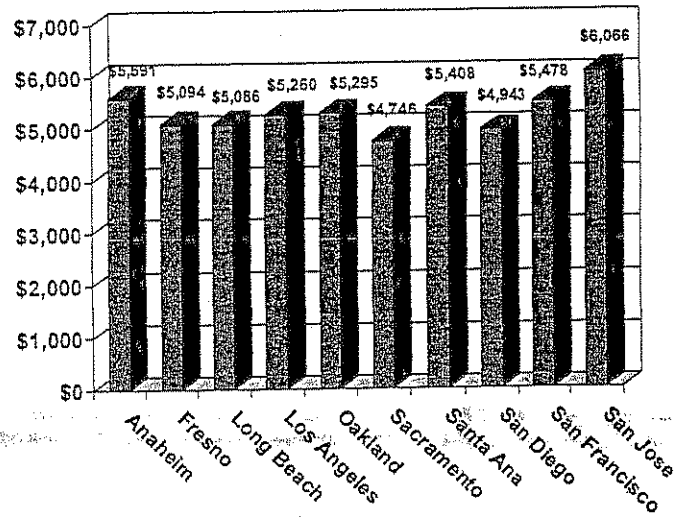
### Economic Environment & Cost Scenarios

- Economic Downturn and Revenue/Budget Shortfalls
- Concern about ability to maintain FY03 Service Levels
- Union reactions include:
  - Skepticism
  - "Not our responsibility to bear"
  - "Would support efforts to raise revenues"
- High expectations of Unions
  - Driven by recent labor settlements
  - Citizen support for public safety workers
  - CPI/Inflation

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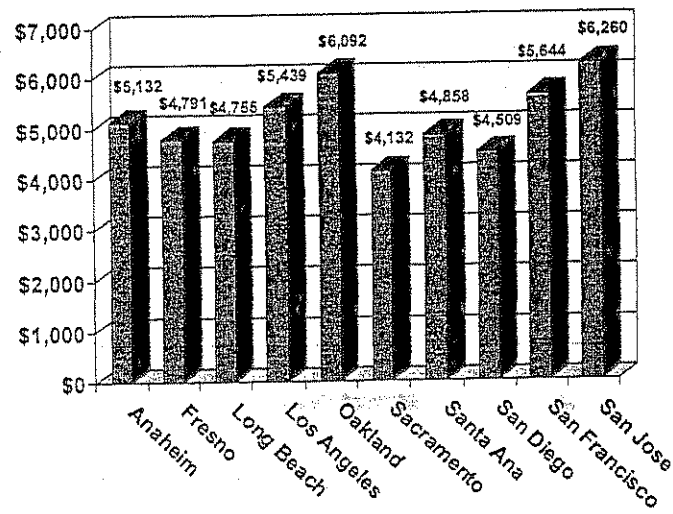
## Police Officer Salary Comparisons



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## Fire Fighter Salary Comparisons

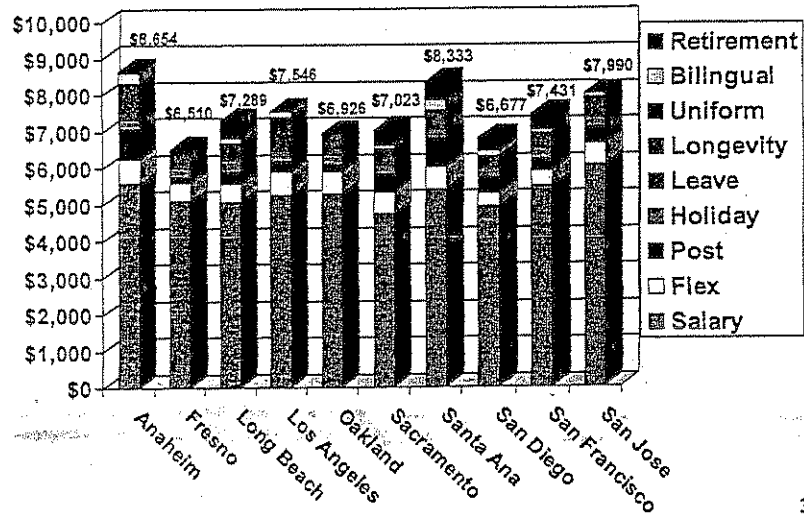


30



## Police Officer Comparisons

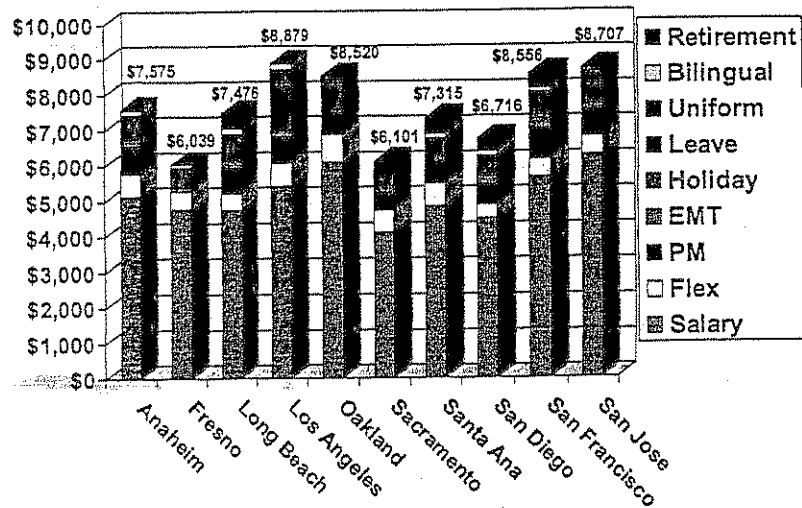
Average Monthly Compensation



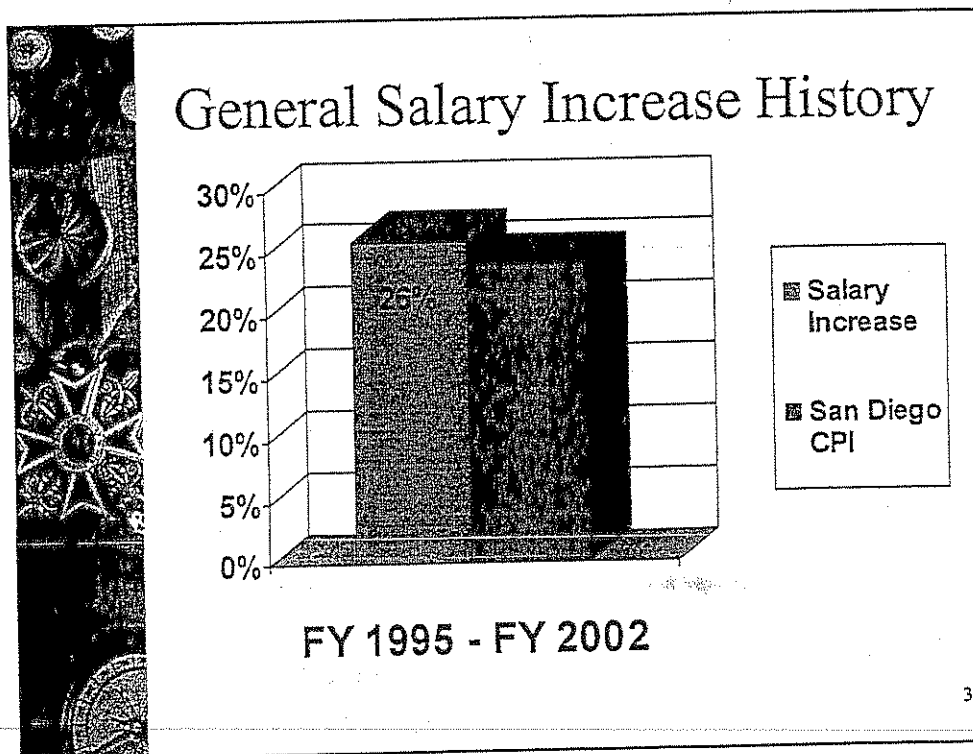
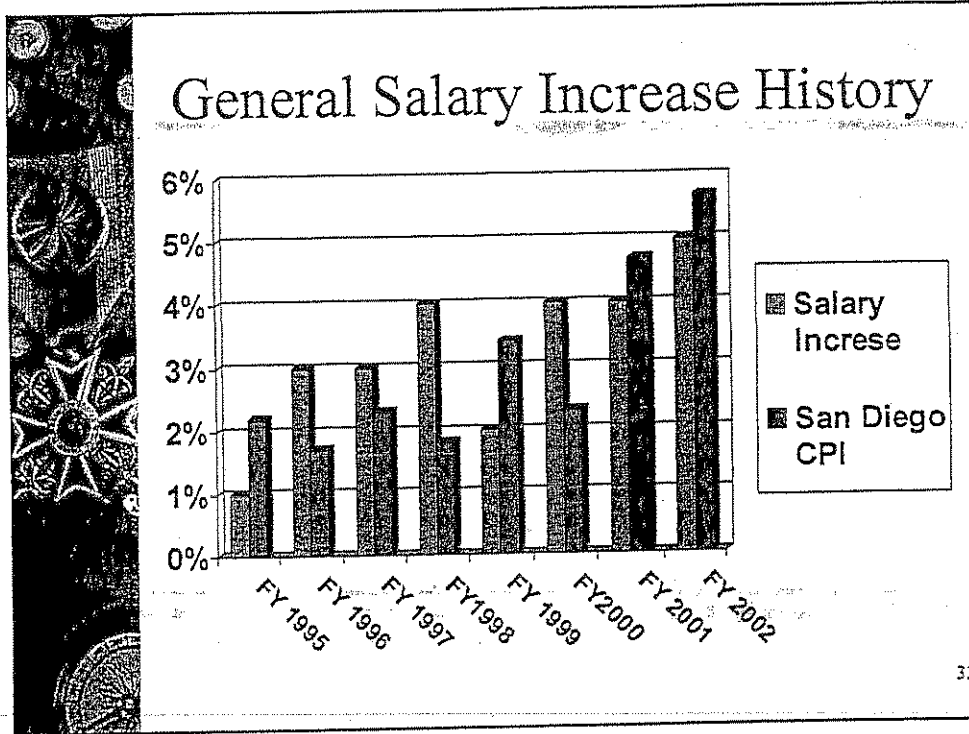
31

## Fire Fighter Comparisons

Average Monthly Compensation



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# Meet & Confer 2002

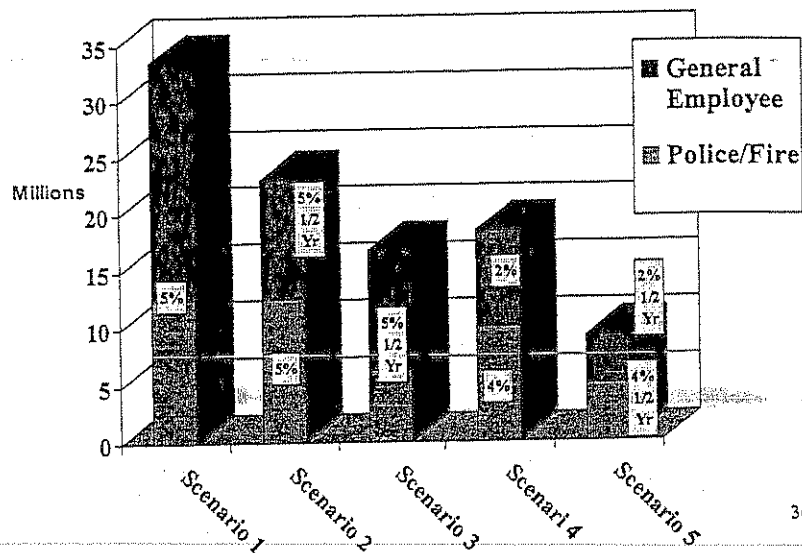
## Economic Environment and Scenarios

### Citywide Cost of Each 1% Economic Increase

➤POA	= 1.73m
➤Fire	= 0.81m
➤MEA	= 3.0m
➤Local 127	= 1.16m
➤Others	= <u>0.74m</u>
➤TOTAL	= 7.44m

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### Citywide Total Cost of Labor Package Scenarios



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## Meet & Confer 2002

### AGENDA

1. Overview
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## Meet & Confer 2002

### Status of Negotiations

- **POA and Local 145**
  - Met 3 or 4 times with each
  - Formal Process
  - Strong Interest in Multi-year Agreement

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## Meet & Confer 2002


### Status of Negotiations

#### ➤ POA and Local 145

##### Numerous and Substantial Economic Proposals

- Salary: 8% year and 5% respectively – multi year
- Move toward average of California Cities
- Retirement Offset
- Special Assignment Pays
- Overtime, Holidays
- Flex Increase
- Workers Comp Improvements
- Out of Class Assignment Pay
- Pay In Lieu, Leaves (Military, Others)

39



## Meet & Confer 2002

### Status of Negotiations

#### ➤ POA and Local 145

##### Major Policy Issues

- Promotional and Transfer Processes
- Discipline and Due Process
- New Classes (PO III, Detective)
- Work Schedules and Rotation Issues
- Drug Testing

40

## Meet & Confer 2002

### Status of Negotiations

#### ➤ MEA and Local 127

- Initial meetings conducted
- Formal bargaining process
- Numerous Economic Proposals
  - 5.6% one-year (MEA)
  - 8.0% one-year (127)
  - 2.5% at 55 retirement formula
  - Flex increase to cover dependents
  - Special Salary Adjustments & Cert Pays
  - Holiday and Leave enhancements

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## Meet & Confer 2002

### Status of Negotiations

#### ➤ MEA and Local 127

##### Major Policy Issues

- Parity *Same % Increase* | *Major Issue*
- Grievance procedure
- Due process enhancements
- Agency shop issues

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## Meet & Confer 2002

### AGENDA

1. Overview
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## Meet & Confer 2002

### City's Initial Economic Proposal

- Will set an initial tone, send a message
- "Parity" in economic proposals, initially and more importantly, in final economic proposals, will be a very serious issue for MEA and Local 127
- A 2 or 3-year offer could accommodate backloading of costs, potentially more attractive

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## Meet & Confer 2002 City's Initial Economic Proposal

Consideration of economic "takeaways"  
not recommended.

Would likely result in impasse, no agreement.

- Mandatory furlough
- Eliminate or suspend pay in lieu
- Reduce overtime guarantees
- Control, reduce holiday work
- Reduce work week

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## Meet & Confer 2002 Action City's Initial Economic Proposal

Recommendation:

	FY03		FY04	
POA & Fire	1% mid-yr	\$1.26m	1% mid-yr	\$1.53m
	+\$100 Flex	\$0.31m	+\$100 Flex	\$0.31m
MEA & Local 127	Retirement*	\$2.08m	1% mid-yr	\$2.08m
	+\$100 Flex	\$0.72m	+\$100 Flex	\$0.72m
TOTAL		\$4.37m		\$4.64m

\*Initial City proposal would be to express willingness to consider 2.5% @ 55 Formula for General Members. City's prospective cost increase of \$2.08m/yr (0.53%) could be paid beginning FY03 or deferred to FY04. Past liability to be paid by City = \$41.7m

46





## Meet & Confer 2002

### City's Initial Economic Proposal

- Management teams will initiate a number of "management rights" and operational proposals
- Will raise serious concerns from Unions
- Will update in closed sessions as negotiations proceed
- Management proposals will include:
  - Personnel Transfers Issues
  - Out of Class Assignment Policies
  - Vacation, Holiday and other Scheduling/Staffing
  - GPS on Public Safety Vehicles

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## Meet & Confer 2002

### AGENDA

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## Meet & Confer 2002

### Retirement System and Meet & Confer

- The System (\$2.6 billion) is funded by:
  - City/Employer contributions (% of payroll)
  - Employee's contributions (% of payroll)
  - Investment earnings of the system's assets

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## Meet & Confer 2002

### Retirement System and Meet & Confer City and Member Contribution Rates FY03

	Employee Member (Average)	City's Actuarial Contribution Rate
Safety	12.84%	24.48%
General	10.01%	11.03%
Blended Rate		15.59%

\*expressed as a % of payroll

50



## Meet & Confer 2002

### Retirement System and Meet & Confer

- The System's Actuary performs an annual "valuation which tests certain "assumptions" against actual experience:
  - Investment return (earnings)
  - Employee withdrawals prior to vesting
  - Mortality rates
  - Disability rates
  - Pay increases
  - Age at retirement
  - Others

51



## Meet & Confer 2002

### Retirement System and Meet & Confer

An annual "*actuarial valuation*" measures the funding status of the system (actuarially computed present value of future retirement liabilities")

FY96 = 91.4%

FY97 = 93.3%

FY98 = 93.6%

FY99 = 93.2%

FY00 = 97.3%

FY01 = 89.9%

52



## Meet & Confer 2002

### Retirement System and Meet & Confer

- System's Board determines City's contribution rate based on annual valuation and a "funding method."
- One of two standard industry funding methods are used in determining employer rates, "Projected Unit Credit" (PUC) or "Entry Age Normal" (EAN)

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## Meet & Confer 2002

### Retirement System and Meet & Confer

- PUC method is more subject to annual fluctuation (City's present method)
- EAN method results in more stable rates to City
- However, the adjustment from PUC to EAN would require an immediate substantial increase in City rates (e.g. +3% or \$15m/year)

54



## Meet & Confer 2002

### Retirement System and Meet & Confer

1. Retirement benefits subject to meet and confer:
  - a. Formulae:
    - 3% at age 50 for safety members
    - 2.25% at 55 for general members
  - b. "Pick Up" by City of Employee's Contribution:
    - 7.3% for safety
    - 5.4% for general members

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## Meet & Confer 2002

### Retirement System and Meet & Confer

1. Retirement benefits subject to meet and confer (continued):
  - c. COLA adjustment post retirement:
    - Currently 2%
  - d. Retiree Health Insurance
    - Up to City's Retiree HMO, post-1980 retirees

56



## Meet & Confer 2002

### Retirement System and Meet & Confer

2. "Vested, Defined Retirement Benefits"  
are actuarially funded guaranteed permanent obligations of the employer:
  - a. Formula driven annuity  
(e.g., 3% at 50, 2.25% at 55)
  - b. 2% COLA
  - c. Disability Benefit, Surviving Spouse, Death
  - d. DROP

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## Meet & Confer 2002

### Retirement System and Meet & Confer

3. "Contingent Benefits" Not actuarially funded payable annually subject to available earnings
  - a. "13<sup>th</sup>" Check
  - b. Supplemental COLA
  - c. "Corbett" settlement (7%) for pre-1997 retirees

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## Meet & Confer 2002

### Retirement System and Meet & Confer

#### 4. Retiree Health Insurance:

- a. Payable from System's 401(h) Trust, indirectly funded from system earnings
- b. Obligation of City's annual budget if 401(h) has insufficient funds

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## Meet & Confer 2002

### Retirement System and Meet & Confer

#### 4. Retiree Health Insurance:

- c. COLA adjustment post retirement:
  - Currently 2%
  - Supplemental COLA (pre-1982)
- d. Retiree Health Insurance
  - Up to City's Retiree HMO, post-1980
  - Up to \$1,200/year pre-1980

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## Meet & Confer 2002

### Retirement System and Meet & Confer The "Manager's Proposal" effective 1/97:

1. Increased benefits for all employees
  - Formula Enhancements for safety & general
  - Established DROP
2. Enhanced retiree health benefits
  - Charter amendment to permit payment of health insurance from 401(h) trust within System
  - Specifically NOT a vested/amortized benefit but paid annually

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## Meet & Confer 2002

### Retirement System and Meet & Confer The "Manager's Proposal" effective 1/97:

3. Established Employer "rate stabilization" plan  
"Agreed to" City Rates increasing .50% per year;  
unless funding ratio drops 10% from FY96 ratio of 92.3%
4. Allocated \$110 m from earnings and reserves to pay the unfunded liability from benefit improvements (\$70 m) and rate stabilization plan (\$10 m).
5. Associated costs and funding impacts were confirmed in writing by the Retirement Board's Actuary (same as today's)

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## Meet & Confer 2002

### Retirement System and Meet & Confer The "Manager's Proposal" effective 1/97:

6. Was formally, in writing, approved by:
  - All 4 labor groups
  - Retirement Independent Fiduciary Counsel
  - City's Outside Fiduciary Counsel
  - Retirement Board of Trustees
  - City Council
7. Was supported by public safety and general member retiree associations

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## Meet & Confer 2002

### Employer Contribution Rate Stabilization Plan

Period	PUC Rate	City Paid Rate	Difference %	Difference \$
FY96	8.60%	7.08%	1.52%	\$5.33m
FY97	10.87%	7.33%	3.79%	\$13.88m
FY98	12.18%	7.83%	4.35%	\$16.67m
FY99	12.18%	8.33%	3.85%	\$15.40m
FY2000	12.18%	8.83%	3.35%	\$14.00m
FY2001	12.18%	9.33%	2.85%	\$12.45m
FY2002	12.18%	9.83%	2.35%	\$10.72m
FY2003	12.18%	10.33%	1.85%	\$8.82m
FY2004	12.18%	10.83%	1.35%	\$6.73m
FY2005	12.18%	11.33%	.85%	\$4.43m
FY2006	12.18%	11.83%	.35%	\$1.91m
FY2007	12.18%	12.18%	-0-	-0-
FY2008	13.00%	13.00%	-0-	-0-
TOTAL				\$110.35

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## Meet & Confer 2002

### Employer Contribution Rate Stabilization Plan

Period	PUC Rate	Actual Rate	City Paid Rate	Difference %	Difference \$	Earnings
FY96	8.60%	8.60%	7.08%	1.52%	\$5.33m	\$150.4m
FY97	10.87%	9.55%	7.33%	3.79%	\$13.88m	\$137.4m
FY98	12.18%*Est	10.87%	7.83%	4.35%	\$16.67m	\$247.4m
FY99	12.18%*Est	10.86%	8.33%	3.85%	\$15.40m	\$189.1m
FY2000	12.18%*Est	11.48%	8.83%	3.35%	\$14.00m	\$415.9m
FY2001	12.18%*Est	11.96%	9.33%	2.85%	\$12.45m	\$168.0m
FY2002	12.18%*Est	12.58%	9.83%	2.35%	\$10.72m	\$ 52.0m est
FY2003	12.18%*Est	15.59%	10.33%	1.85%	\$8.82m	
FY2004	12.18%*Est		10.83%	1.35%	\$6.73m	
FY2005	12.18%*Est		11.33%	.85%	\$4.43m	
FY2006	12.18%*Est		11.83%	.35%	\$1.91m	
FY2007	12.18%*Est		12.18%	-0-	-0-	
FY2008	13.00%*		13.00%	-0-	-0-	
TOTAL					\$110.35	

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## Meet & Confer 2002

### Retirement System and Meet & Confer

The "Manager's Proposal" effective 1/97:

#### Earnings Compared with Funding Ratio

FY96	\$150.4 m	91.4%
FY97	\$137.4 m	93.3%
FY98	\$247.4 m	93.6%
FY99	\$189.1 m	93.2%
FY00	\$415.9 m	97.3%
FY01	\$168.0 m	89.9%
FY02 Est.	\$50 to \$60 m	?

- \$105 m reserve would drop to = 85.6%
- Corbett, if amortized = 83.1%
- "Trigger" in Manager's Proposal requiring City to pay full rate = 82.3%  
(a potential \$40m annual impact)

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## Meet & Confer 2002

### Retirement System and Meet & Confer

- Retirement enhancements have been funded
  - By increasing City and employee contributions, and/or
  - By absorbing as a future liability of the Retirement System
- Given recent actuarial losses of the System, any consideration to absorb costs must carefully evaluate impact on System's funding ration

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## Meet & Confer 2002

### Action

#### Recommendations For Active Employee Plans:

1. Authorize renewals at premiums shown earlier with PacifiCare and Kaiser
2. Authorize modified co-pays by employees that standardize plan designs for PacifiCare (Option 1) and Kaiser (Option 2) HMO plans in line with industry standard:
  - \$10 office visit co-pays by employees
  - \$5 generic/\$10 brand Rx with formulary
  - \$50 emergency room co-payment

OK

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## Meet & Confer 2002 Action

### Recommendations for Retiree Health:

1. Authorize renewals with PacifiCare and Kaiser
2. Authorize modified co-pays by employees that standardize plan designs for PacifiCare and Kaiser HMO plans and are in line with industry standard:
  - ♦ \$10 office visit co-pay by employees
  - ♦ \$5 generic/\$10 brand Rx with formulary
  - ♦ \$50 emergency room co-payment *OK*

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## Meet & Confer 2002 Action

### City's Initial Economic Proposal

#### Recommendation:

	FY03		FY04	
POA & Fire	1% mid-yr	\$1.26m	1% mid-yr	\$1.53m
	+\$100 Flex	\$0.31m	+\$100 Flex	\$0.31m
MEA & Local 127	Retirement*	\$2.08m	1% mid-yr	\$2.08m
	+\$100 Flex	\$0.72m	+\$100 Flex	\$0.72m
TOTAL		\$4.37 m		\$4.64m

\*Initial City proposal would be to express willingness to consider 2.5% @ 55 Formula for General Members. City's prospective cost increase of \$2.08m/yr (0.53%) could be paid beginning FY03 or deferred to FY04. Past liability to be paid by City = \$41.7m 70



## Meet & Confer 2002

### AGENDA

1. Overview
2. Health Insurance Renewals (Action)
3. Economic Environment & Cost Scenarios (Info)
4. Status of Negotiations (Info)
5. City's Initial Economic Proposals (Action)
6. Retirement System/Meet & Confer (Info)
6. *Next Steps*

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## Meet & Confer 2002

### Next Steps

- Management Teams will introduce initial proposals
- Early April, will return to closed session with cost information, alternatives and recommendations related to Union's economic proposals, including Retirement costs and funding alternatives
- Mid-April, CSC recommendations on special salary adjustments/new classes (per Charter Section 130) will be presented for direction to Management Teams
- Throughout April, will update in Closed Session on status of negotiations and request additional bargaining authority as appropriate

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